Pillar 3 2020

Contents

1.	Executive Summary	03
2.	Risk Management	07
3.	Capital Resources	36
4.	Capital Requirements	42
5.	Credit Risk	45
6.	Operational Risk	58
7.	Counterparty Credit Risk	58
8.	Liquidity Risk	59
9.	Asset Encumbrance	60
10.	Securitisation	62
11.	Other Matters	62
12.	Remuneration	63
13.	Gender Diversity	68

Index of tables

Table 1:	RWA Summary	06
Table 2:	Key Ratios	06
Table 3:	Capital Composition	37
Table 4:	Capital instruments main features	38
Table 5:	LRSum - Summary reconciliation of accounting assets and leverage ratio exposures	40
Table 6:	LRCom - Leverage ratio common disclosure	40
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	41
Table 8:	EU OV1 – Overview of risk-weighted assets	42
Table 9:	Capital Requirements	43
Table 10:	Countercyclical Capital Buffer	44
Table 11:	Amount of institution-specific countercyclical capital buffer	45
Table 12:	EU CRB-B - Total and average net amount of exposures	46
Table 13:	EU CRB-C - Geographical breakdown of exposures	47
Table 14:	EU CRB-E - Residual maturity of exposures	48
Table 15:	EU CRB-D - Concentration of exposures by industry	49
Table 16:	Expected credit loss expense	51
Table 17:	Staging approach under IFRS 9	53
Table 18:	EU CR1-A - Credit quality of exposures by exposure class	54
Table 19:	Loss allowance under IFRS 9	55
Table 20:	EU CR2-B – Changes in the stock of defaulted and impaired loans and debt securities	55
Table 21:	Impaired exposures and past due exposures by industry	56
Table 22:	Total exposures covered by credit risk mitigation	56
Table 23:	Exposure by credit quality step	57
Table 24:	Operational risk RWAs	58
Table 25:	EU CCR1 - Counterparty credit risk Mark-to-market method	59
Table 26:	EU CCR2 - Credit Valuation Adjustment	59
Table 27:	EU LIQ1 – Liquidity coverage ratio	60
Table 28:	Encumbered and unencumbered assets (Template A)	61
Table 29:	Sources of encumbrance (Template C)	62
Table 30:	Exposure value of purchased securitisation	62
Table 31:	EVE Sensitivity analysis	63
Table 32:	Remuneration for material risk takers	67
Table 33:	Special payments to staff	67
Table 34:	Deferred remuneration	67
Table 35:	Remuneration of EUR 1 million or more per year	68

Pillar 3

1. Executive Summary

This Pillar 3 disclosure complements and expands on information disclosed in Metro Bank PLC's ("Metro Bank" or "the Bank") 2020 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').

Common Equity Tier 1 ('CET1') ratio

15.0%

(2019: 15.6%)

See page 37

Tier 1 capital ratio

15.0%

(2019: 15.6%)

See page 37

Total capital ratio

18.1%

(2019: 18.3%)

See page 37

CRR Leverage ratio

5.6%

(2019: 6.6%)

See page 40

Liquidity Coverage Ratio ('LCR')

187%

(2019: 197%)

See page 60

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

7,957

(2019: 9,147)

See page 37

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

22,579

(2019: 21,400)

See page 40

Pillar 3 continued

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.

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.

Metro Bank PLC has 12 subsidiaries, of which four are dormant. Metro Bank PLC is regulated by the Prudential Regulatory Authority ('PRA') and Financial Conduct Authority ('FCA') and a number of subsidiaries are regulated by the FCA only. Metro has applied for, and been granted, permission to use the individual consolidation method when producing prudential returns. There are no differences between the basis of consolidation for accounting and regulatory purposes. Further details on the Bank's subsidiaries can be found in note 39 of the 2020 Annual Report and Accounts.

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.

Scope

Metro Bank PLC is a UK based bank that provides services to retail and commercial clients. It is authorised by the PRA and regulated by the PRA and FCA and is required to comply with regulatory rules implemented by the PRA, who have continued to uphold those from the 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 CRR. 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.

This document sets out our 2020 Pillar 3 Disclosure in accordance with the rules laid out in the CRR (Part 8) and our Pillar 3 Policy Document. In meeting the regulatory requirements, this document provides information on Metro Bank's capital and liquidity position, risk management processes, regulatory methodologies and disclosure. The purpose of these disclosures is to give information on the basis of calculating Basel III capital requirements and on the management of the risks that 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 2020, our financial year end, with comparative figures for 31 December 2019 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. For the year ended 31 December 2020 we used the Standardised Approach to credit risk and market risk and the Basic Indicator Approach ('BIA') to operational risk.

Frequency of disclosures

Our Pillar 3 Disclosures are published annually in conjunction with the date of publication of our financial statements.

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 ('CRM') balances. As mentioned in section 5, all balances are disclosed 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 Credit Quality Steps ('CQS') 1, both pre and post-CRM.
- Counterparty credit risk amounts to less than 1% of total RWAs. Consequently, on the grounds of materiality no further details are provided in accordance to templates EU CCR5-A and EU CCR6.

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 Globally Systemically Important Institution ('G-SII').
- CRR Article 452: We use the standardised approach to credit risk, not the IRB approach.
- CRR Article 454: We use the Basic Indicator Approach ('BIA') to operational risk, not the Advanced Measurement Approach ('AMA').
- CRR Article 455: We do not use Internal Market Risk Models

We have also omitted disclosures specified by EBA/GL/2020/07 which are in response to the COVID-19 crisis on the grounds that the PRA have waived the application of the disclosure templates for firms that are not G-SII's or Other Systemically Important Institutions ('O-SII').

Changes to disclosures

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 2019 report. The key changes include:

- additional table disclosed in section 5.1.5 Charges for specific credit risk adjustments;
- additional table added in section 5.2.4 Credit Risk Mitigation; and
- additional commentary and tables disclosed within section 12 Remuneration, to meet CRD V requirements.

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 G-SII's, O-SII's 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.

Regulatory measures announced last year, known as the 'CRR quick-fix' package, in light of COVID-19, accelerated the implementation of certain CRR2 amendments which are due to be implemented in full from 1 January 2022. The benefit of both the revised SME supporting factor and treatment of software intangible assets have been recognised in the capital ratios. While this is the case, the PRA has announced their intention in CP5/21 to modify the regulatory requirements and we expect that software will return to being fully deducted prior to 1 January 2022. We are therefore not considering the benefit when making capital decisions today or in our longer-term strategic planning.

The package also included amendments to the IFRS 9 transitional add-back to capital. Metro Bank applies IFRS 9 transitional arrangements and the new amendments allowed for 100% relief on stage 1 and stage 2 impairment provisions recognised since 1 January 2020. This additional relief will apply to the Bank's capital ratios throughout 2021 before reducing on a straight-line basis over the following three years.

Summary of risk profile

Effective risk management underpins everything we do and is critical to realising our strategic priorities. We have an established risk management framework to manage and report the various risks that we face over the course of our daily business.

The Bank continues work to implement a new regulatory reporting system as well as establishing a new robust internal assurance function within the finance and regulatory team, further strengthening the control framework. Following on from the solid base established for regulatory reporting in 2019,

Pillar 3 continued

culminating in the reasonable assurance opinion from PwC on the 2019 CET1 and total capital ratios, the focus for 2020 has been on ensuring that the transformational changes within regulatory reporting remain embedded and effective. The final aspects of the transformational programme not completed in 2019 pertain to the implementation of a new regulatory reporting system, Moody's Analytics.

During 2020, Metro Bank has also continued its focus on the undertakings required to seek IRB accreditation. A successful accreditation would leverage the transformation already achieved in regulatory reporting and those in flight across the broader business, given the IRB dependencies on the regulatory and risk management frameworks. Controls reporting will be further enhanced in 2021. This will enable the Audit Committee to assess the effectiveness of the controls as the strategy of the Bank continues to evolve, coupled with the additional requirements for data collection and regulatory reporting as a result of changes in the macroeconomic environment which required rapid large scale change to respond to customer needs.

Further details on our approach to risk management can be found in the Risk report on pages 7 to 37.

In summarising the movement in risk metrics for 2020:

Table 1: RWA Summary

	2020 £'million	2019 £'million
Credit Risk	**7,251**	8,591
Counterparty Credit Risk	**7**	5
Market Risk	**14**	5
Operational Risk	**686**	546
Total RWA	**7,957**	9,147

Table 2: Key Ratios

	31 December 2020 £'million	31 December 2019 £'million
Common Equity Tier 1 ('CET1') ratio	**15.0%**	15.6%
Tier 1 capital ratio	**15.0%**	15.6%
Total capital ratio	**18.1%**	18.3%
Total capital plus MREL ratio	**22.4%**	22.1%
CRR Leverage ratio	**5.6%**	6.6%
Liquidity Coverage Ratio ('LCR')	**187%**	197%
Risk Weighted Assets ('RWAs')	**7,957**	9,147
Total assets as per published financial statements	**22,579**	21,400

The tables above summarises the key regulatory figures and metrics on a transitional basis as at 31 December 2020. CET1 capital fell £235 million to £1,192 million (31 December 2019: £1,427 million) which was mainly due to increases in impairment provisions due to the COVID-19 pandemic.

The ratios are above the minimum requirements with our CET1 minimum requirement being 7.6% (31 December 2019: 8.8%), Tier 1 minimum requirement being 9.3% (31 December 2019: 10.6%) and Total capital minimum requirement being 11.5% (31 December 2019: 13.0%), excluding any confidential PRA buffers.

The reduction in RWAs reflects the mortgage portfolio disposal and capital efficient lending through government-backed BBLS and CBILS together with lending discipline in other areas.

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

Richard Lees
Chief Risk Officer
23 March 2021

2. Risk Management

Effective risk management underpins everything we do and is critical to realising our strategic priorities. We have an established risk management framework to manage and report the various risks that we face over the course of our daily business. The framework:

- is the totality of systems, structures, policies, processes and people that identify, measure, evaluate, control, mitigate, monitor and report all internal and external sources of material risk;
- ensures all principal and emerging risks are identified, assessed, mitigated, monitored and reported;
- ensures risk appetite is clearly articulated and influences the strategic plan;
- promotes a clearly defined risk culture that emphasises risk management across all areas of the Bank; and
- undertakes ongoing analysis of the environment in which we operate and proactively addresses potential risk issues as they arise.

Risk appetite, policies and procedures

In line with our business model, outlined within the 2020 Annual Report and Accounts, we strive to generate long-term tangible book growth as well as sustainable growth for all our stakeholders. Risk appetite is defined as the level and types of risk we are willing to take within the boundaries of our risk capacity, to achieve these objectives. We achieve this by developing Risk Appetite Statements which articulate our risk appetite to stakeholders and provide a view on the risk-taking activities with which the Board is comfortable, guiding decision makers in their strategic and business decisions. Summaries of our Risk Appetite Statements are included within the relevant principals risks on pages 12 to 33.

Our Risk Appetite Statements convey the balance required between risk-taking and the commercial and reputational implications of doing so, promoting good customer outcomes and protecting us from excessive exposure. The Risk Appetite Statements include qualitative and quantitative limits which inform strategies, targets, policies, procedures and other controls that collectively ensure we remain within the Board's approved risk appetite. Information on performance against relevant Risk Appetite Statement settings, breaches and trends is reported to the Executive Risk Committee ('ERC'), Risk Oversight Committee and Board regularly.

In addition to our Risk Appetite Statements we have developed a Risk Policy Framework as a key component of our risk management. The Risk Policy Framework provides structure and governance for the consistent and effective management of policies we develop in order to manage our risk appetite. These policies define the minimum control requirements that must be observed across the Bank to manage material sources of risk within risk appetite.

Risk governance and oversight

We have a structured risk governance framework which strengthens our approach to risk management as well evaluating new risks. This allows us to manage the changing regulatory environment in an efficient and effective manner.

Effective operation of a 'three lines of defence' model is integral to our approach to risk management and is based on the overriding principle that risk capability must be embedded within the first line of defence teams to be effective. Responsibility for risk management resides at all levels within the Bank and is supported by Board and Executive-level committees. The table on page 9 sets out how responsibility for risk management is allocated and how that responsibility is discharged.

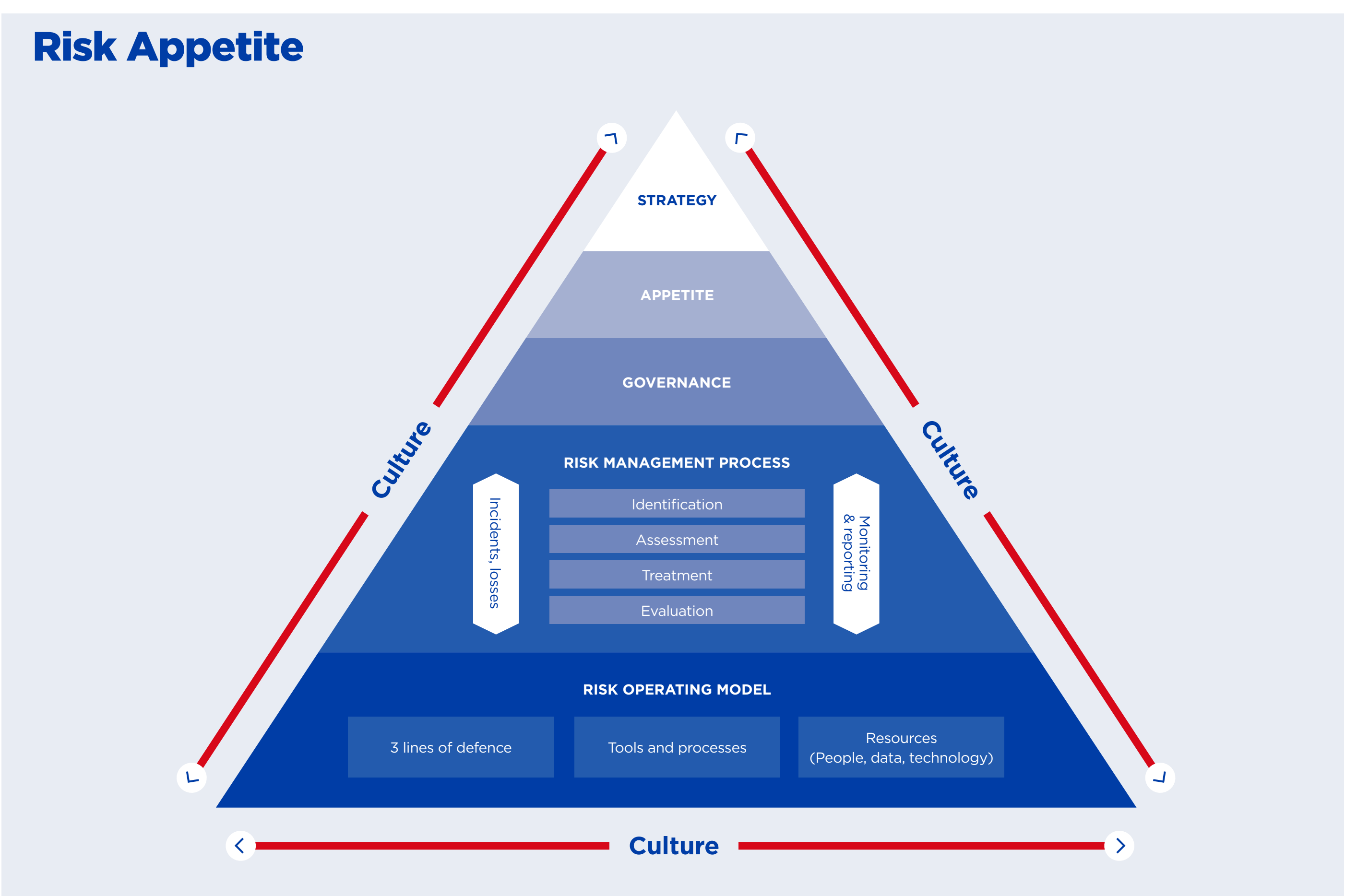
Risk culture

A critical supporting factor of the risk management framework is our culture, which supports risk awareness by encouraging every colleague to think about the relationship between their role and our purpose of creating FANS and growing safely and sustainably. This culture begins with our Executive team, which leads by example with consistent and clear communication of our commitment to managing risk at all levels of the organisation.

Personal accountability is at the heart of our risk culture. This is enabled through the Senior Managers and Certification Regime framework, which supports colleagues to make risk-informed decisions. Risk management is also included in every colleague's objectives each year and is embedded within our scorecard, against which performance is measured. Colleagues are recruited with the core skills, abilities and attitude required to fulfil their role. They are provided with training and development to ensure they maintain and develop the required levels of competence. This supports colleagues in making decisions and judgements with risk in mind.

We know that a culture that truly focuses on creating FANS by exceeding customers' expectations will reduce the risk of customer harm and deliver consistently good outcomes. We continually seek to enhance and further embed our risk management framework to ensure effective risk ownership and management within risk appetite, supporting appropriate customer outcomes, and the delivery of our strategic plan. We promote an environment of effective challenge in which decision-making processes stimulate a range of views. During the year, we have implemented several initiatives that have further strengthened and embedded the risk management framework within the business, increasing commitment to and understanding of risk management across all colleagues.

Risk Appetite



Changes in principal risks and risk profile

In line with the UK Corporate Governance Code requirements, we have performed a robust assessment of the principal and emerging risks we face, including those that could result in events or circumstances that might threaten our business model, future performance, solvency or liquidity, and reputation. In deciding on the classification of principal risks, we considered the potential impact and probability of the related events and circumstances and the timescale over which they may occur. The principal risk categories remain similar to those outlined in the Annual Report and Accounts 2019, with changes relating to the identification of capital risk as a principal risk and the recognition of climate risk as a cross-cutting risk, which manifests through the existing principal risk framework.

An overview of the principal risks and mitigating actions is set out below, while further information on all of the principal risks can be found on pages 12 to 33.

During the year, we have been working hard to support our customers and minimise the impact of COVID-19 for businesses and households across the UK, maintaining our customer service operations and store distribution with minimal interruption. We have also participated in the various UK Government-backed loan schemes for businesses, in addition to offering payment holidays to mortgage, personal and business customers.

Our response to the pandemic demonstrates the robustness of our approach to risk management and mitigation as we continue to successfully manage these events. Like many businesses, COVID-19 has, however, increased our risk profile. The measures introduced to support the economy create new operational, conduct and financial risks for the Bank. These risks are being managed and will be monitored over time.

BOARD
SETS RISK APPETITE AND STRATEGY

- Sets our strategy, corporate objectives, risk appetite.
- Ensures an adequate framework is in place for reporting and managing risk.
- Maintains an appropriate control environment to manage risk effectively.
- Ensures capital, liquidity and other resources are adequate to achieve our objectives within risk appetite.

RISK OVERSIGHT COMMITTEE
OVERSEES RISK GOVERNANCE AND MANAGEMENT

- Recommends risk appetite statement measures to the Board.
- Reviews risk exposures in relation to the risk appetite.
- Reviews risk policies, and approves or recommends to the Board for approval.
- Monitors the effectiveness of risk management processes and procedures put in place by management.

EXECUTIVE-LEVEL COMMITTEES
OVERSEE THE RISK MANAGEMENT FRAMEWORK

Executive Risk Committee

- Endorses the risk appetite for approval by the Board and monitors performance against risk appetite.
- Reviews and recommends risk policies for approval by the Board or Risk Oversight Committee.
- Reviews and endorses risk frameworks and tools.
- Oversees the quality and composition of the credit risk portfolio, and recommends strategies to adjust the portfolio.

Model Oversight Committee

- Oversees model governance and model risk monitoring.
- Approves all material models.

Asset and Liability Committee

- Monitors performance against the Board capital/funding plans.
- Ensures that the Bank meets internal liquidity and capital targets.
- Agrees pricing decisions to ensure visibility of capital and liquidity impacts.
- Monitors interest rate risk.

Credit Approval Committee

- Approves higher value lending requests, policy exceptions.

1ST LINE OF DEFENCE: CHIEF EXECUTIVE OFFICER, EXECUTIVES AND THEIR TEAMS
OWN AND MANAGE RISK

- Own and manage risk on a day-to-day basis.
- Design, implement and maintain effective controls.
- Align strategy with, and monitor exposure against, risk appetite.
- Ensure adequate resources, tools and training in place.
- Promote and maintain an appropriate risk culture.

2ND LINE OF DEFENCE: CHIEF RISK OFFICER AND THE RISK FUNCTION
DESIGN AND MAINTAIN THE RISK MANAGEMENT FRAMEWORK

- Design and maintain the risk management framework.
- Establish and review risk policies and standards.
- Facilitate the development of risk appetite, tools and training.
- Ensure that key risks are identified, assessed and managed.
- Provide oversight, review and challenge to the first line.
- Report to Executive Management and the Board.

3RD LINE OF DEFENCE: AUDIT COMMITTEE AND INTERNAL AUDIT FUNCTION
PROVIDE ASSURANCE THAT THE RISK MANAGEMENT FRAMEWORK IS OPERATING EFFECTIVELY

- Assess the adequacy/effectiveness of the control environment.
- Independently verify that the risk management framework is operating effectively.
- Conduct reviews of risk management controls/procedures.

Pillar 3 continued

The table below summarises the changes in our risk profile since 2019 and the key risk implications of the pandemic.

PRINCIPAL RISK	RISK MOVEMENT IN 2020	IMPACT OF COVID-19
Credit risk The risk of financial loss should our borrowers or counterparties fail to fulfil their contractual obligations in full and on time.	 Although the impacts on our retail and business credit portfolios are yet to fully manifest, it is clear that the level of risk has increased, with levels of defaults expected to increase over time, particularly once government support schemes come to an end.	We have participated in regulatory and government support schemes, with a priority focus on supporting existing customers through COVID-19. Capital repayment holidays, interest free overdrafts (for retail customers) and extensions of credit, as well as other flexible supporting measures, continue to be provided and monitored. Policies, risk appetite, credit decisioning and supporting frameworks have been reviewed and updated to reflect the changing environment and risk profiles.
Operational risk The risk that events arising from inadequate or failed internal processes, people and systems, or from external events cause regulatory censure, reputational damage, financial loss, service disruption and/or detriment to our FANS.	 The risk has increased, driven by increased remote working, the implementation of new processes and pressure on customer support areas arising from changing customer needs, which could lead to increased errors or delays and subsequent losses.	COVID-19 brought heightened people risk as some of our colleagues worked to keep our stores open, whilst others worked from home. It also necessitated changes to working practices, which are managed closely via an enhanced governance structure. We are now investigating permanent improvements that can be made.
Liquidity and funding risk The risk that we fail to meet our short-term obligations as they fall due. The risk that we cannot fund assets that are difficult to monetise at short notice (i.e. illiquid assets) with funding that is behaviourally or contractually long term (i.e. stable funding).	 Liquidity and funding risk has decreased during the year, increasing stability.	The impact of COVID-19 has resulted in an overall improvement to our overall liquidity profile through improved deposit balances and participation in the Bounce Back Loan Scheme, with clients placing funds drawn-down on deposit, prior to their utilisation. This effect has been observed across the industry and is anticipated will be temporary in nature.
Market risk The risk of loss arising from movements in market prices. Market risk is the risk posed to earnings, economic value or capital that arises from changes in interest rates, market prices or foreign exchange rates.	 Market risk has remained stable through the year.	Not directly impacted by COVID-19, we are able to manage and hedge interest rate risk through different rate environments.
Financial crime risk The risk of financial loss or reputational damage due to regulatory fines, 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.	 The risk has decreased during the year due to enhancements made to our AML and Sanctions controls through the Financial Crime Improvement Programme. Overall fraud attacks continue to significantly increase in line with what is being seen across the industry, year on year; albeit, in 2020, fraud losses have reduced from 2019.	New government support schemes have provided opportunities for fraudsters and we have implemented controls to counter their attempts.

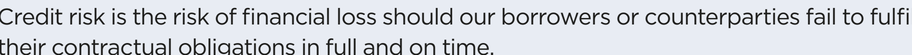
PRINCIPAL RISK	RISK MOVEMENT IN 2020	IMPACT OF COVID-19
Regulatory compliance risk The risk of failing to understand and comply with relevant laws and regulatory requirements; not keeping regulators informed of relevant issues; not responding effectively to information requests or failing to meet regulatory deadlines; or obstructing the regulator.	 We remain exposed to regulatory and compliance risk as a result of significant ongoing and new regulatory change. We will seek to comply with all regulations as they evolve, and as customer expectations continue to develop.	We have deployed multiple new policies and processes to implement government, regulatory and central bank COVID-19 support measures. Additional regulatory and compliance risks are associated with adherence to both COVID-19-specific regulatory guidance and with existing regulation. Consequently, additional risk assessments, governance processes and assurance activities have been deployed across the Bank.
Conduct risk The risk of treating customers unfairly and delivering poor outcomes that lead to customer detriment, such as financial loss and/or distress and inconvenience. This can also result in wider adverse impacts, for example, loss of our FANS, reputational damage, regulatory and/or legal action.	 The risk has increased driven by the impact of the external environment, namely COVID-19 and the UK economy, where customers are increasingly more vulnerable to dramatic income changes, job losses and behavioural changes driven by social/political agendas.	COVID-19 has generally had a detrimental impact on customers' financial stability and affordability due to income loss caused by furlough and/or complete job loss. This has resulted in increased reliance on savings, inability to meet repayment demands and the need for the regulator and lenders to introduce enhanced forbearance measures, such as payment deferrals. We have now sought to include some of these measures as part of our ongoing collections strategy.
Model risk The risk of potential loss and regulatory non-compliance due to decisions that could be principally based on the output of models, due to errors in the development, implementation or use of such models.	 The risk has increased as a result of the rapid application of COVID-19 model adjustments.	The uncertain economic environment has affected all model components including input data, default markers, outputs, model accuracy and performance.
Capital risk The risk that we fail to meet minimum regulatory capital (and MREL) requirements. Management of capital is essential to the prudent management of our balance sheet, ensuring our resilience under stress, and the maintenance of the confidence of our current and potential creditors (including bondholders, the bond market, and customers) and key stakeholders in the pursuit of our business strategy.	 Our capital ratios were broadly flat year-on-year. We took action to strengthen our MREL resources through the sale of a portfolio of owner-occupied residential mortgages, which is in line with our strategy to enhance risk-adjusted returns on capital through the ongoing focus on balance sheet optimisation. We also purchased the peer-to-peer lender RateSetter, to provide unsecured personal loans direct to customers.	There have been several regulatory capital developments in the UK and Europe in response to COVID-19, which have reduced certain capital requirements for banks across the industry. Additionally, in order to provide operational capacity for banks to respond to the immediate financial stability priorities resulting from the impact of COVID-19, both the PRA and Basel communicated revised timelines across key regulatory initiatives.

Further information on our principal risks are set out on pages 12 to 33.

1. Credit risk

Definition

Change since 2019: Increased



Credit risk is the risk of financial loss should our borrowers or counterparties fail to fulfil their contractual obligations in full and on time.

Appetite

We have a moderate appetite for credit risk. As part of our strategic priorities we are rebalancing our lending mix, increasing the proportion of unsecured lending which will lead to an increased level of credit risk. Our tolerance for credit loss has been set within our ability to meet our capital requirements but also reflects the increased level of risks associated with COVID-19. Our metrics, and how we monitor them, will allow for informed decisions and meaningful risk management action to take place to ensure our capital and other resources are adequate in order to achieve our long-term strategic objectives.

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. At 31 December 2020, 84% (31 December 2019: 95%) of our loans consisted of retail mortgages and commercial term loans secured on collateral, with average debt-to-value of 56% (2019: 59%) and 56% (2019: 60%) respectively.

Our exposure to loans of greater than 100% debt to value (or where no real estate collateral is present) remains low at less than 1% of retail mortgage lending (31 December 2019: less than 1%) and 12% of commercial term lending (31 December 2019: 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 figures, so the true credit risk exposure on these loans is lower and is underwritten on the strength of all types of collateral.

Table A: Retail mortgage lending by DTV

	31 December 2020 £'million			31 December 2019 £'million		
	Retail owner occupied	Retail buy-to-let	Total retail mortgages	Retail owner occupied	Retail buy-to-let	Total retail mortgages
DTV ratio						
Less than 50%	**1,855**	**502**	**2,357**	2,647	464	3,111
51–60%	**842**	**390**	**1,232**	1,383	393	1,776
61–70%	**836**	**533**	**1,369**	1,422	505	1,927
71–80%	**1,084**	**407**	**1,491**	1,813	554	2,367
81–90%	**359**	**4**	**363**	1,201	13	1,214
91–100%	**74**	**–**	**74**	23	–	23
More than 100%	**1**	**5**	**6**	4	8	12
Total retail mortgage lending	**5,051**	**1,841**	**6,892**	8,493	1,937	10,430

Table B: Commercial term lending by DTV (excluding BBLS)

	31 December 2020 £'million			31 December 2019 £'million		
	Professional buy-to-let	Other term loans	Total commercial term loans	Professional buy-to-let	Other term loans	Total commercial term loans
DTV ratio						
Less than 50%	**353**	**876**	**1,229**	363	911	1,274
51–60%	**261**	**546**	**807**	283	535	818
61–70%	**351**	**255**	**606**	404	343	747
71–80%	**133**	**100**	**233**	135	86	221
81–90%	**9**	**51**	**60**	10	31	41
91–100%	**6**	**13**	**19**	12	37	49
More than 100%	**4**	**411**	**415**	12	384	396
Total commercial term loans	**1,117**	**2,252**	**3,369**	1,219	2,327	3,546

We have developed an automated credit approval process for consumer lending and retail mortgages utilising credit scorecards, affordability calculators and policy rules. This is supported by a team of skilled manual underwriters for more complex decisions, who operate within agreed delegated lending authorities, and a clear Credit Policy and Lending Standards.

All commercial lending is individually reviewed. This is undertaken by Relationship Managers and a specialist team of commercial underwriters, reviewing these proposals in accordance with agreed delegated lending authorities. It is underpinned by a commercial lending policy supported by sector-specific standards and guidelines.

Undrawn commitments

At 31 December 2020, we had undrawn loan facilities of £769 million (2019: £726 million). This includes commitments of £351 million (2019: £296 million) in respect of credit card and overdraft facilities. These commitments represent agreements to lend in the future, subject to certain conditions. Such commitments are cancellable, subject to notice requirements, and given their nature are not expected to be drawn down to the full level of exposure. 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. We also have exposure to Invoice Finance assets (£36 million drawn on limits of £138 million) where the amount drawn is capped both by the discounted value of available invoices and a set relationship cap. Similarly, we have a small exposure to Commercial Real Estate Development Finance, where a limit to draw down is agreed in principle and funds are released in stages, throughout the development and following satisfactory surveyor reports. In commercial lending, undrawn commitments are regularly reviewed to ensure relationship caps remain appropriate. This has been particularly evident during 2020 as we continue to support customers through COVID-19.

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. At 31 December 2020, this risk arises principally in the mortgage book where the exposure to interest-only loans stands at £4.1 billion (31 December 2019: £4.4 billion). There is further exposure to refinance risk in the Commercial Book of £1.3 billion (31 December 2019: £1.5 billion) from interest-only loans and a portion of amortising term loans.

All borrowers of interest-only lending are assessed as being able to refinance the lending at the end of the term or have an appropriate repayment plan in place. These loans are also appropriately collateralised (see lending and collateral section on page 12), ensuring we have a first charge in the event of default by the borrower. The reduction in owner occupied mortgages is as a result of the £3.1 billion retail mortgage sale, agreed in December 2020.

1. Credit risk continued

Table C: Retail mortgage lending by repayment type

	31 December 2020 £'million			31 December 2019 £'million		
	Retail owner occupied	Retail buy-to-let	Total retail mortgages	Retail owner occupied	Retail buy-to-let	Total retail mortgages
Repayment						
Interest	**2,337**	**1,751**	**4,088**	2,573	1,834	4,407
Capital and interest	**2,714**	**90**	**2,804**	5,920	103	6,023
Total retail mortgage lending	**5,051**	**1,841**	**6,892**	8,493	1,937	10,430

Table D: Commercial term lending (excluding BBLS)

	31 December 2020 £'million			31 December 2019 £'million		
	Professional buy-to-let	Other term loans	Total commercial term loans	Professional buy-to-let	Other term loans	Total commercial term loans
Repayment						
Interest	**1,058**	**281**	**1,339**	1,155	328	1,483
Capital and interest	**59**	**1,971**	**2,030**	64	1,999	2,063
Total commercial term loans	**1,117**	**2,252**	**3,369**	1,219	2,327	3,546

Sector exposure

We manage the level of credit risk concentration based on individual borrowing entities and sector. Our credit risk appetite includes limits for high risk sectors and/or high levels of concentration.

Within commercial lending we set credit risk policy and lending standards for key sectors. We have specialist sector lending teams including in healthcare, hospitality, and property.

Over 2020, we have observed that some sectors have been more severely impacted by COVID-19 lockdowns. Hospitality has experienced a more significant reduction in income than other sectors, and as a consequence we are seeing higher levels of COVID-19 support required by these customers.

Table E: Commercial term lending by sector exposure (excluding BBLS)

	31 December 2020 £'million			31 December 2019 £'million		
	Professional buy-to-let	Other term loans	Total commercial term loans	Professional buy-to-let	Other term loans	Total commercial term loans
Industry sector						
Real estate (rent, buy and sell)	**1,117**	**1,032**	**2,149**	1,219	1,155	2,374
Hospitality	–	**376**	**376**	–	308	308
Health and social work	–	**248**	**248**	–	263	263
Legal, accountancy and consultancy	–	**208**	**208**	–	236	236
Retail	–	**107**	**107**	–	100	100
Real estate (development)	–	**60**	**60**	–	62	62
Recreation, cultural and sport	–	**53**	**53**	–	51	51
Construction	–	**36**	**36**	–	35	35
Education	–	**30**	**30**	–	30	30
Real estate (management of)	–	**10**	**10**	–	11	11
Investment and unit trusts	–	**9**	**9**	–	8	8
Other	–	**83**	**83**	–	68	68
Total commercial term loans	**1,117**	**2,252**	**3,369**	1,219	2,327	3,546

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. We are expanding our footprint over time to reduce geographical concentration of lending. All of our current loans' exposures are secured on UK-based collateral. A geographic analysis of the location of retail mortgage collateral and commercial term loan (excluding BBLS) collateral is set out below:

Table F: Retail mortgages by geographic exposure

	31 December 2020 £'million			31 December 2019 £'million		
	Retail owner occupied	Retail buy-to-let	Total retail mortgages	Retail owner occupied	Retail buy-to-let	Total retail mortgages
Region						
Greater London	**2,213**	**1,147**	**3,360**	3,424	1,197	4,621
South East	**1,157**	**309**	**1,466**	2,094	337	2,431
South West	**433**	**91**	**524**	738	97	835
East of England	**298**	**73**	**371**	570	76	646
North West	**265**	**63**	**328**	482	66	548
West Midlands	**179**	**58**	**237**	340	62	402
Yorkshire and the Humber	**139**	**37**	**176**	275	37	312
East Midlands	**131**	**25**	**156**	243	26	269
Wales	**102**	**21**	**123**	169	21	190
North East	**62**	**10**	**72**	93	11	104
Scotland	**72**	**7**	**79**	65	7	72
Total retail mortgage lending	**5,051**	**1,841**	**6,892**	8,493	1,937	10,430

Table G: Commercial term loans by geographic exposure (excluding BBLS)

	31 December 2020 £'million			31 December 2019 £'million		
	Professional buy-to-let	Other term loans	Total commercial term loans	Professional buy-to-let	Other term loans	Total commercial term loans
Region						
Greater London	**780**	**1,358**	**2,138**	850	1,414	2,264
South East	**205**	**399**	**604**	224	424	648
South West	**31**	**156**	**187**	52	156	208
East of England	**48**	**67**	**115**	35	104	139
North West	**20**	**146**	**166**	21	115	136
West Midlands	**10**	**66**	**76**	11	49	60
Yorkshire and the Humber	**3**	**13**	**16**	11	26	37
East Midlands	**11**	**18**	**29**	5	12	17
Wales	**5**	**10**	**15**	4	10	14
North East	**3**	**18**	**21**	4	9	13
Scotland	**1**	**–**	**1**	1	3	4
Northern Ireland	**–**	**1**	**1**	1	5	6
Total commercial term loans	**1,117**	**2,252**	**3,369**	1,219	2,327	3,546

1. Credit risk continued

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 2020 we held £3.4 billion (31 December 2019: £2.6 billion) of investment securities, which are used for balance sheet and liquidity management purposes, of which £3.4 billion (31 December 2019: £2.4 billion) is eligible as collateral at the BoE.

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

Table H: Investment securities by credit rating

	31 December 2020 £'million			31 December 2019 £'million		
	Investment securities held at amortised cost	Investment securities held at FVOCI	Total	Investment securities held at amortised cost	Investment securities held at FVOCI	Total
Credit rating						
AAA	**2,184**	**385**	**2,569**	1,943	156	2,099
AA- to AA+	**456**	**388**	**844**	144	255	399
A- to A+	**–**	**–**	**–**	67	–	67
Lower than A-	**–**	**–**	**–**	–	–	–
Total	**2,640**	**773**	**3,413**	2,154	411	2,565

We have a robust securities investment policy which requires us to invest in high-quality liquid debt instruments. At 31 December 2020, 75% of our investment securities were rated as AAA (31 December 2019: 82%) with a further 25% (31 December 2019: 16%) rated AA- or higher.

Additionally, we hold £3.0 billion (31 December 2019: £3.0 billion) in cash balances, which is either held by ourselves or at the BoE, where there is minimal credit exposure.

Oversight

Credit risk is overseen by the Chief Risk Officer ('CRO') (supported by the Chief Credit Officer ('CCO')), ERC and ROC.

The Credit Risk function reports to the CRO and is led by the CCO. It is responsible for:

- Recommending and overseeing credit risk appetite limits.
- Maintaining credit risk policies and standards.
- Overseeing credit risk strategies in accordance with policies and risk appetite.
- Providing an independent review of individual commercial credit proposals and renewals of loan facilities.
- Monitoring credit risk performance and reporting to the Executive Risk Committee and Risk of Committee.
- Developing and monitoring credit risk models.
- Ensuring appropriate IFRS 9 credit provisions.
- Developing and overseeing of retail collections and recoveries strategies.
- Managing commercial collections and recoveries strategy and activities.

In addition, our Treasury Risk team, which is led by the Director of Prudential Risk and reports to the CRO, supports the development and implementation of applicable policies and procedures and monitors the credit risk aspects of the Treasury portfolio.

Measurement

Economic weightings

We measure credit quality for impairment purposes under IFRS 9. We have taken a cautious approach to assessing our impairment provisions in order to set aside appropriate portfolio provision coverage for the anticipated economic deterioration and increase in credit losses that is expected over the coming period.

Our IFRS 9 models utilise a blend of several economic scenarios provided by Moody's Analytics. The weightings of these scenarios reflect the UK economic outlook arising from COVID-19 and Brexit. The macroeconomic assumptions applied can be found in note 31 of the Annual Report and Accounts. Our credit risk models are subject to internal model governance including independent validation. We undertake annual model reviews and have regular model performance monitoring in place.

The impairment provisions recognised during the year reflect our best estimate of the level of provisions required for future credit losses as calibrated under our conservative weighted economic assumptions and following the application of expert credit risk judgement overlays.

Use of Post Model Adjustments and Post Model Overlays

To supplement the models, we also applied expert credit risk judgement through post model adjustments and post model overlays.

Post Model Adjustments refer to increases/decreases in ECL to address known model limitations, either in model methodology or model inputs. These rely on analysis of model inputs and parameters to determine the change required to improve model accuracy. These may be applied at an aggregated level, however they will usually be applied at account level.

Post Model Overlays reflect management judgement. These rely more heavily on expert judgement and will usually be applied at an aggregated level. For example, where recent changes in market and economic conditions have not yet been captured in the macroeconomic factor inputs to models (e.g. industry-specific stress event).

The appropriateness of post model adjustments and post model overlays is subject to rigorous review and challenge, including review by the Audit Committee (see page 94 of the Annual Report and Accounts).

Further details on our use of post model adjustments and post model overlays can be found on page 210 of the Annual Report and Accounts.

Regulatory measurement

As of 31 December 2020, 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 and have rolled out use of commercial rating and slotting models during 2020.

Monitoring

We monitor credit risk performance through a suite of reports covering performance against risk appetite limits and key credit risk metrics, including: new business flow; portfolio quality; early warning indicators; arrears and recovery performance; sector and geographical concentration; and exceptions to lending policy. Reports are provided to ERC, the ROC and the Board on a monthly basis. Credit risk performance is supported by portfolio reviews and deep dives on material portfolios and key credit risk themes.

Early Warning and Non-performing loans

In line with IFRS 9, we allocate all loans into Stages 1, 2 and 3 to reflect likelihood of loss.

- Stage 1 includes those loans where the credit risk has not increased significantly since the loan was originally agreed.
- Stage 2 includes those loans where the credit risk has increased significantly, but which are not impaired.
- Stage 3 includes loans which are non-performing.

The risk of loss increases through these stages. Under IFRS 9, the potential for a loan to default is calculated on a 12-month horizon at Stage 1, and a lifetime horizon at Stages 2 and 3.

1. Credit risk continued

COVID-19 has been a significant factor in customers' ability to make payments. We have worked with customers to assist with how best to manage repayments, and have provided payment deferral options as an option, in line with regulatory guidance. This customer support package has kept arrears lower, and is expected to make return to repayment easier for most customers – a trend we have seen as customers have begun to roll off payment holidays.

We expect to see increasing numbers of customers experiencing financial difficulties, as restrictions continue to impact trading, liquidity is used up, and repayments start to fall due on government support loans. Commercial customers are managed through early warning categorisation where there are early signs of financial difficulty. The overriding objective is to identify, at an early stage, those customers for whom we believe repayment difficulties may develop, thereby allowing timely engagement and appropriate corrective action to be taken. Early Warning categorisation supports IFRS 9 Stage Allocation.

In Retail, we monitor for early signs of financial difficulty to enable appropriate customer support.

COVID-19 has also materially impacted the volume of lending in Early Warning categories over 2020. The main sector exposures within Early Warning categories reflect the key commercial term lending industry sectors: Real Estate; Hospitality; Recreation, Cultural and Sport are particularly affected. The majority of customers in Early Warning categories have received COVID-19 support including payment holidays or government backed loans, and we anticipate an increase in the number of customers requiring further COVID support.

Non-performing loans

Non-performing loans are loans that have more than three instalments unpaid (90+ days past due) or where the debtor is assessed as unlikely to pay our credit obligations in full without recourse to legal action to recover the debts in full, regardless of the existence of any past-due amount or of the number of days past due. All non-performing loans are included within Stage 3.

Where a debtor is facing difficulties meeting financial commitments, Metro Bank is able to offer forbearance. Forbearance is a concession either through a change to the terms and conditions of the loan, or a refinance of the loan. To be forborne, the customer is in or is about to face financial difficulties. Loans which have been renegotiated within existing credit policy where the customer is not in financial difficulties are not forborne. All forborne loans are included within Stage 3. Customers who have sought COVID support in the form of payment deferrals or temporary conversion to interest only payments are not considered forborne, by virtue of having sought that support. However, this may be a contributing factor for an account to be allocated in Stage 2.

Commercial loans in Stage 3 are individually assessed with consideration for the collateral provided against the loan. Provisions are reported and overseen through Impairment Committee to Executive Risk Committee.

COVID

COVID-19 has and will continue to materially impact the volume of lending classified as Stage 2 and Stage 3. In anticipation of this, a number of model adjustments have been put in place to reflect those losses, the full extent of which has yet to materialise.

Table I: Non-performing loans

	31 December 2020		31 December 2019	
Group	Non-performing loans £'million	Non-performing loan ratio	Non-performing loans £'million	Non-performing loan ratio
Retail-residential mortgages	**118**	**1.70%**	25	0.24%
Retail-consumer and other	**13**	**6.13%**	10	4.30%
Commercial (including asset and invoice finance)	**127**	**2.48%**	42	1.12%
Total	**258**	**2.10%**	77	0.53%

The deterioration of the non-performing loan ratio from 31 December 2019 to 31 December 2020 for all portfolios is primarily driven by customers who have received temporary COVID-19 support measures and now require further forbearance support which has been classified as unlikeliness to pay criteria in the definition of default.

Cost of risk

Cost of risk is credit impairment charges expressed as a percentage of average gross lending. The increase has been primarily driven by COVID-19. There has been a significant deterioration in macroeconomic scenarios as well as increases in arrears and forbearance. This has driven an overall increase in the ECL expense.

Table J: Cost of risk

Group	2020	2019
Retail-residential mortgages	**0.19%**	0.00%
Retail-consumer and other	**5.97%**	1.92%
Commercial (including asset and invoice finance)	**1.99%**	0.11%
Average cost of risk	**0.86%**	0.08%

Regulatory and Government support schemes

We have remained focused on supporting customers through COVID-19 and have participated in the various Government support schemes. Payment deferrals and temporary payment conversion to interest-only for loans, interest-free overdrafts, and extensions of credit have all been made available.

We have provided BBLS to our customers with loans of between £2,000 and £50,000. These are available for up to 10 years, with no repayments due in the first year, at a fixed rate. Changes made as part of the 'Pay as you Grow' scheme allow customers to apply for an interest only payment period of six months (up to a maximum of three periods) with an additional payment deferral period, for both capital and interest, also up to six months. These loans are 100% guaranteed by the government.

CBILS allows for loans of over £50,000 to a maximum of £5 million. These have been made available at variable rates of lending with no arrangement fees and 0% interest for the first 12 months. The Government has guaranteed 80% of the loss and pays the fees as well as the interest for the first 12 months. The maximum term of these loans is six years.

CLBILS provides loans of over £50,000, up to a maximum of £200 million. These have also been made available at a variable rate of lending, with terms ranging between three months and three years. The government guarantees 80% of any loss on these loans.

At 31 December 2020 we have £1.35 billion of loans for BBLS, £114 million (with a further £19 million approved) in CBILS and £27 million (with further £3 million approved) in CLBILS. Whilst these loans are guaranteed by the government, costs to collect are expected, and the risks associated from these loans is being closely monitored and reassessed where necessary, particularly as new government guidance is made available.

Table K: COVID-19 Government Backed Loans

Group	Number of Customers	Drawn Balance £'million	Average Loan Amount £'000
BBLS	**36,139**	**1,353**	**37**
CBILS	**277**	**114**	**411**
CLBILS	**3**	**27**	**9,122**
Total	**36,419**	**1,494**	**41**

1. Credit risk continued

COVID-19 support measures

COVID-19 support measures including payment deferrals and temporary payment conversions to interest only have been made available as part of our commitment to support our customers through COVID-19.

Less than 1% of mortgage customers currently have part or full payment deferrals. 22% of all mortgage customers have been granted deferrals in 2020 and 1% of customers remain. Of those customers who took a payment deferral, 90% have returned to full contractual payments with only 6% moving into arrears or requiring additional support.

7% of commercial customers currently have COVID-19 support measures in place, predominantly capital and interest payment holidays. 75% of commercial customers who have previously been granted COVID-19 support have now returned to full contractual terms.

Of our retail unsecured customers, 1% of customers have currently been granted payment deferral; 8% have taken a payment deferral over 2020 with 85% of those returning to contractual payments. Of those that have returned, 33% have moved into arrears or require additional support.

Table L: COVID-19 support

	Granted to Date		31 December 2020	
Group	Total Balances £'million	% of Total Balances	Total Balances £'million	% of Total Balances
Retail Mortgages	1,540	22%	68	1%
Commercial Lending	1,011	29%	251	7%
Retail Unsecured	13	8%	2	1%
Total	**2,564**	**24%**	**321**	**3%**

2. Operational risk

Definition

Operational risk is the risk that events arising from inadequate or failed internal processes, people and systems, or from external events cause regulatory censure, reputational damage, financial loss, service disruption and/or detriment to our FANS.

Change since 2019:
Increased

Appetite

We maintain a low appetite for Operational Risk. We aim to minimise incidents and losses arising from operational risk issues by maintaining a resilient infrastructure, including robust systems, employing and training the right colleagues, minimising the impact of external events and having a framework in place to ensure that operational risks are captured, monitored and mitigated.

Mitigation

Policies

We have detailed policies, procedures and controls in place that are designed to mitigate operational risks both through minimising impacts suffered in the normal course of business (expected losses) and to avoid or reduce the likelihood of suffering a large extreme (or unexpected) loss.

Cyber and information security

Our Chief Information Security Officer ('CISO') is responsible for ensuring robust cyber and information security. We continuously invest in our cyber and information security infrastructure in order to improve services, protect customer data and minimise the risk of disruption. We also take pre-emptive actions to safeguard the end-to-end resilience of critical processes. We continue to enhance the control environment, recognising the changing cyber landscape and the increased focus on digital capabilities and reliance on home working, as well as the changing risk profile of the business.

Operational resilience

Operational resilience is demonstrated in the mitigation of risks that impact our people, technology, third parties, and premises. By identifying critical end-to-end processes, focus can be given to those processes and the controls in place, including management of the technology upon which they rely, to minimise disruption. The need for strong operational resilience is inherent in the provision of services to customers. As customer expectations and use of services evolves we will need to maintain focus on the resilience of services. COVID-19 highlights the ongoing exposure to external risks and threats that can be unpredictable in nature and widespread in impact. Our response to COVID-19 to date has ensured that critical services have continued in the safest manner possible for both customers and colleagues. The ongoing nature of the pandemic will continue to present risks to our resilience and these are monitored continually.

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 FANS, whilst maintaining a safe, reliable and resilient banking operation.

Measurement

Material operational risk events are identified, reviewed and escalated in line with criteria set out in the Risk Management Framework. Root cause analysis is undertaken and action plans are implemented. Losses may result from both internal and external events, and are categorised using risk categories aligned to Basel II. We also measure operational risk using a number of quantitative metrics. These KRIs are defined, reported against and escalated to the Business Risk Committees, Executive Risk Committee and Risk Oversight Committee.

We also develop and maintain a suite of operational risk scenarios using internal and external data. These scenarios provide insights into the stresses the business could be subject to given extreme circumstances. Scenarios cover all material operational risks including execution of change, failures to core processes or contagion risk from a third party. Scenarios are owned by senior management custodians with review and challenge provided by the Risk function, Executive Risk Committee and Risk Oversight Committee, as part of the ICAAP process.

Monitoring

We have built detection capabilities to monitor and alert us about system attacks and we use incident management procedures and playbooks to respond to attacks accordingly.

We continuously develop and embed our approach to the management of operational risks, with the aim of maintaining robust operational processes, systems and controls, including conducting Risk and Control Self-Assessments across the Bank.

Operational risk is overseen by the CRO, Business Risk Committees, Executive Risk Committee and Risk Oversight Committee.

3. Liquidity and funding risk

Change since 2019:
Decreased

Definition
Liquidity Risk is the risk that we fail to meet our short-term obligations as they fall due. Funding Risk is the risk that we cannot fund assets that are difficult to monetise at short notice (i.e. illiquid assets) with funding that is behaviourally or contractually long term (i.e. stable funding).

Appetite
We have a moderate appetite for Liquidity Risk and Funding Risk. We shall be able to survive a combined name-specific and market-wide liquidity stress event for at least three months, at a level of severity determined by our internal stress test, utilising our Liquidity Pool. Equally, we shall maintain a prudent funding profile by using stable funding to fund illiquid assets, without reliance on wholesale funding markets, whilst ensuring that funding is not inappropriately concentrated by customer, sector, or term, as identified during our liquidity stress testing.

Mitigation

Deposit-funded approach
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 2020, 44.3% of our deposits came from commercial customers (31 December 2019: 40%) with the remaining 56% (31 December 2019: 60%) coming from retail customers. Additionally, 39% of deposits at year end (31 December 2019: 29%) were in the form of current accounts, with the remainder split between a combination of instant access and fixed-term savings products. In 2020 our cost of deposits was 0.65% (2019: 0.78%).

Our deposit base during the year and at year end remains stable and resilient throughout the pandemic, with retail deposits forming a higher portion of our balance sheet than commercial deposits.

Liquidity management
We continue 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 ensures that we comply with our own risk appetite as well as regulatory requirements.

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

The tables below 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, they 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.

Recovery planning
The Recovery Plan details a series of indicators that 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 chaired by the CFO, which sits as required in the event of a liquidity stress.

Term Funding Scheme repayments

Term Funding Scheme ('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. In March 2020, the Bank of England announced a revised TFS with additional incentives for SMEs. In December 2020, TFSME drawdowns were undertaken for £550 million with an expected maturity of 2024. We intend to continue to utilise the TFSME scheme in 2021 while our existing TFS drawings will be repaid using a combination of excess liquidity and by utilising TFSME.

Table M: Contractual maturity

	Carrying value £'million	Repayable on demand £'million	Up to 3 months £'million	3–6 months £'million	6–12 months £'million	1–5 years £'million	Over 5 years £'million	No contractual maturity £'million	Total £'million
31 December 2020									
Cash and balances with the Bank of England	**2,993**	**2,993**	**–**	**–**	**–**	**–**	**–**	**–**	**2,993**
Loans and advances to customers	**12,385**	**–**	**332**	**281**	**634**	**4,551**	**11,424**	**284**	**17,506**
Investment securities	**3,413**	**–**	**87**	**233**	**221**	**2,768**	**140**	**59**	**3,508**
Other assets	**3,788**	**–**	**2,568**	**–**	**–**	**–**	**–**	**1,220**	**3,788**
Total assets	**22,579**	**2,993**	**2,987**	**514**	**855**	**7,319**	**11,564**	**1,563**	**27,795**
Deposits from customers[1]	**(16,072)**	**(12,550)**	**(641)**	**(864)**	**(1,233)**	**(702)**	**–**	**(119)**	**(16,109)**
Deposits from central banks	**(3,808)**	**–**	**(692)**	**(588)**	**(1,500)**	**(1,033)**	**–**	**–**	**(3,813)**
Debt securities	**(600)**	**–**	**–**	**(23)**	**(24)**	**(719)**	**–**	**–**	**(766)**
Repurchase agreements	**(196)**	**–**	**–**	**–**	**(49)**	**(155)**	**–**	**–**	**(204)**
Lease liabilities	**(327)**	**–**	**(7)**	**(7)**	**(15)**	**(115)**	**(273)**	**–**	**(417)**
Other liabilities	**(287)**	**–**	**–**	**–**	**–**	**–**	**–**	**(287)**	**(287)**
Total liabilities	**(21,290)**	**(12,550)**	**(1,340)**	**(1,482)**	**(2,821)**	**(2,724)**	**(273)**	**(406)**	**(21,596)**
Equity	**(1,289)**	**–**	**–**	**–**	**–**	**–**	**–**	**(1,289)**	**(1,289)**
Total equity and liabilities	**(22,579)**	**(12,550)**	**(1,340)**	**(1,482)**	**(2,821)**	**(2,724)**	**(273)**	**(1,695)**	**(22,885)**
Derivative cashflows		**–**	**(3)**	**(1)**	**(3)**	**(2)**	**–**	**–**	
Cumulative liquidity gap		**(9,557)**	**(7,913)**	**(8,882)**	**(10,851)**	**(6,258)**	**5,033**		

	Carrying value £'million	Repayable on demand £'million	Up to 3 months £'million	3–6 months £'million	6–12 months £'million	1–5 years £'million	Over 5 years £'million	No contractual maturity £'million	Total £'million
31 December 2019									
Cash and balances with the Bank of England	2,989	2,989	–	–	–	–	–	–	2,989
Loans and advances to customers	14,681	–	349	317	584	4,191	16,893	395	22,729
Investment securities	2,565	–	209	229	74	1,924	215	60	2,711
Other assets	1,165	–	–	–	–	–	–	1,165	1,165
Total assets	21,400	2,989	558	546	658	6,115	17,108	1,620	29,594
Deposits from customers[1]	(14,477)	(9,720)	(601)	(1,102)	(1,838)	(1,178)	–	(115)	(14,554)
Deposits from central banks	(3,801)	–	(6)	(7)	(556)	(3,274)	–	–	(3,843)
Debt securities	(591)	–	–	(23)	(23)	(766)	–	–	(812)
Repurchase agreements	(250)	–	(54)	–	–	(204)	–	–	(258)
Lease liabilities	(341)	–	(7)	(7)	(14)	(119)	(329)	–	(476)
Other liabilities	(357)	–	–	–	–	–	–	(357)	(357)
Total liabilities		(9,720)	(668)	(1,139)	(2,431)	(5,541)	(329)	(472)	(20,300)
Equity	(1,583)	–	–	–	–	–	–	(1,583)	(1,583)
Total equity and liabilities	(21,400)	(9,720)	(668)	(1,139)	(2,431)	(5,541)	(329)	(2,055)	(21,883)
Derivative cash flows		–	(2)	(1)	(2)	(9)	–	–	
Cumulative liquidity gap		(6,731)	(6,843)	(7,437)	(9,212)	(8,647)	8,132		

1. Deposits from customers with no contractual maturity comprises of notice accounts. These accounts continue indefinitely until the customer gives notice to withdraw some or all of the funds. Notice periods range from 30 to 100 days and customers cannot access their funds on demand, even with a penalty.

3. Liquidity and funding risk continued

Measurement

Our asset and liability management 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 are set out in the Recovery Plan. Colleagues monitor these on a regular basis 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.

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. We have a dedicated Treasury Risk team who monitor our liquidity and funding risk including ensuring compliance with the policies we have development. The Regulatory Reporting team also monitors compliance with LCR.

The Asset & Liability Committee 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. Our LCR has remained strong throughout the year, ending 2020 at 187% (2019: 197%).

4. Market risk

Definition

Market risk is the risk of loss arising from movements in market prices. It is the risk posed to earnings, economic value or capital that arises from changes in interest rates, market prices or foreign exchange rates.

Change since 2019:
No change

Appetite

We have a moderate appetite for Market Risk, and do not have a trading book. Market Risk arises naturally as a result of taking deposits from customers and lending to customers. Market Risk is closely monitored and managed to ensure the level of risk remains within appetite, with key metrics reported to senior management and the Board.

Mitigation

Interest rate risk

We benefit from natural offsetting between certain assets and liabilities, which may be based on both the 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 to ensure that risks are managed appropriately – and that we are well-positioned to avoid losses outside our appetite, in the event of unexpected market moves.

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

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 GBP. We do not have any operations outside the United Kingdom. We offer currency accounts and foreign exchange facilities to facilitate basic customer requirements only.

Measurement

We measure interest rate risk exposure using methods including the following:

- 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 that 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 BoE 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 GBP, 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 ensure prompt action and limit excesses are escalated to the Asset & Liability Committee. A digest of interest rate risk measures and details of any excesses are presented monthly at the Asset & Liability Committee.

Internal Asset & Liability Committee Limits are set for the economic value of equity and net interest income based on the worse of a +200bps or -200bps instantaneous symmetrical parallel shock to interest rates. The economic value of equity and net interest income limits are monitored daily by risk. Performance against limits is reported monthly to the Asset & Liability Committee (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 BoE base rate. Our Treasury Risk function runs a series of other interest rate risk simulations on a monthly basis to ensure that the Asset & Liability Committee 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 us 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 and loss account.

The tables below set out the interest rate risk repricing gaps of our balance sheet in the specified time buckets, indicating how much of each type of asset and liability reprices in the indicated periods, after applying expected non-contractual and out-of-course early repayments in line with the Market Risk Policy. During 2020 we have updated the tables to better reflect our behavioural assumptions on deposits and equity as well as to provide increased granularity. The comparative tables for 2019 have also been updated to reflect these changes.

4. Market risk continued

Table N: Repricing analysis

	Up to 3 months £'million	3-6 months £'million	6-12 months £'million	1-5 years £'million	Over 5 years £'million	Non-interest bearing £'million	Total £'million
31 December 2020							
Cash and balances with the Bank of England	**2,913**	**–**	**–**	**–**	**–**	**80**	**2,993**
Loans and advances to customers[1]	**4,665**	**538**	**1,083**	**5,924**	**175**	**–**	**12,385**
Investment securities	**2,343**	**65**	**–**	**910**	**95**	**–**	**3,413**
Other assets	**2,568**	**–**	**–**	**–**	**–**	**1,220**	**3,788**
Total assets	**12,489**	**603**	**1,083**	**6,834**	**270**	**1,300**	**22,579**
Deposits from customers	**(8,761)**	**(1,091)**	**(1,657)**	**(4,563)**	**–**	**–**	**(16,072)**
Deposits from central banks and repurchase agreements	**(3,808)**	**–**	**(47)**	**(149)**	**–**	**–**	**(4,004)**
Debt securities	**–**	**–**	**–**	**(600)**	**–**	**–**	**(600)**
Other liabilities[2]	**–**	**–**	**–**	**–**	**–**	**(614)**	**(614)**
Equity	**(886)**	**(40)**	**(79)**	**(284)**	**–**	**–**	**(1,289)**
Total equity and liabilities	**(13,455)**	**(1,131)**	**(1,783)**	**(5,596)**	**–**	**(614)**	**(22,579)**
Interest rate derivatives	**389**	**(125)**	**–**	**(264)**	**–**	**–**	
Interest rate sensitivity gap	**(577)**	**(653)**	**(700)**	**974**	**270**	**686**	**–**
Cumulative gap	**(577)**	**(1,230)**	**(1,930)**	**(956)**	**(686)**	**–**	**–**

	Up to 3 months £'million	3-6 months £'million	6-12 months £'million	1-5 years £'million	Over 5 years £'million	Non-interest bearing £'million	Total £'million
31 December 2019							
Cash and balances with the Bank of England	2,989	–	–	–	–	–	2,989
Loans and advances to customers	4,565	639	1,506	7,962	9	–	14,681
Investment securities	2,068	–	3	472	22	–	2,565
Other assets	–	–	–	–	–	1,165	1,165
Total assets	9,622	639	1,509	8,434	31	1,165	21,400
Deposits from customers	(6,462)	(1,212)	(2,066)	(4,737)	–	–	(14,477)
Deposits from central banks and repurchase agreements	(3,855)	–	–	(196)	–	–	(4,051)
Debt securities	–	–	–	(591)	–	–	(591)
Other liabilities[2]	–	–	–	–	–	(698)	(698)
Equity	(634)	(50)	(100)	(799)	–	–	(1,583)
Total equity and liabilities	(10,951)	(1,262)	(2,166)	(6,323)	–	(698)	(21,400)
Interest rate derivatives	964	(90)	(245)	(628)	(1)	–	
Interest rate sensitivity gap	(365)	(713)	(902)	1,483	30	467	–
Cumulative gap	(365)	(1,078)	(1,980)	(497)	(467)	–	–

1. Loans and advances to customers at 31 December 2020 includes the £295 million of loans and advances classified as held for sale.
2. Other liabilities includes lease liabilities which are shown as non-interest bearing category. Whilst interest expense is recognised on these liabilities within the income statement this interest is not paid like other financial liabilities. The maturities of the lease liabilities shown on the balance sheet are set out below:

Lease liability maturity profile

	Up to 3 months £'million	3–6 months £'million	6–12 months £'million	1–5 years £'million	Over 5 years £'million	Total £'million
31 December 2020	(7)	(7)	(15)	(102)	(196)	(327)
31 December 2019	(7)	(7)	(14)	(101)	(212)	(341)

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 multiple 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 upon projected net interest income for a one-year forecasting period.

Table O: Interest rate sensitivity

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
31 December 2020	19.8	(20.1)
31 December 2019	8.1	(8.2)

5. Financial crime risk

Definition

Financial crime risk is the risk of financial loss or reputational damage due to regulatory fines, 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.

Appetite

We have no appetite for establishing or maintaining customer relationships or executing transactions that facilitate financial crime and have no appetite for sanctions breaches. Relationships with customers where it is felt that the financial crime risks are too great to manage effectively will be ended and continual investment is made in our expertise, partnerships and systems to improve our management of risk in this area. We will not tolerate any deliberate breach of financial crime laws and regulations that apply to our business and the transactions we undertake.

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 and standards in 2020 to ensure alignment with regulatory obligations.

Our Financial Crime Improvement Programme, which was mobilised in 2019, continued to deliver enhancements to our business-wide financial crime systems and controls throughout 2020. This programme will continue to deliver a Bank-wide framework to ensure Financial Crime controls are designed in line with regulatory requirements and build new capability to manage financial crime risk into 2021.

5. Financial crime risk continued

Resourcing and training

Resourcing continues to be a significant focus for the Bank 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 2020 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 compliance

We continue to review our sanctions compliance framework with the support of external advisers, following our notifications to regulators on the sanctions matters discovered in 2017 and 2019. The Financial Crime Improvement Programme has delivered multiple enhancements to our sanctions compliance capabilities in 2020 and will continue to do so throughout 2021.

Anti-money laundering and combating terrorist financing prevention

We comply with all relevant UK Anti-Money Laundering and Combating Terrorist Financing legislation. The Financial Crime Improvement Programme continues to deliver enhancements to our customer due diligence capabilities, transaction monitoring, customer and payment screening capabilities. The programme ensures we continue to effectively prevent, detect and treat potential out-of-appetite financial crime activities.

Anti-bribery and corruption and anti-tax evasion compliance

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 any facilitation of tax evasion. We are committed to acting professionally, fairly and with integrity in all our business dealings and relationships.

Fraud prevention

We have continued to invest in fraud prevention tools and further capability in 2020. This, in addition to historic investment, has resulted in significant savings by preventing attempted frauds against our customers and the Bank itself.

During the pandemic, we have seen fraudsters continue to target customers through authorised and unauthorised payment fraud attempts. Alongside this we have also seen an increase in the use of social engineering techniques to attempt to obtain customers' personal and security details, using reasons related to COVID-19 and scams topical to the pandemic, including pets, vaccines and personal protective equipment. We have continued to share fraud prevention trends and best practice via our various communication channels to help our customers protect against such attacks.

We have supported our customers during these difficult times by providing government-funded schemes and we have implemented fraud capabilities to limit attempted fraud against these schemes. We have worked closely with the British Business Bank, other banks, network operators and law enforcement to identify and reduce the fraud risk in relation to BBLS applications.

In 2021, we will continue to work closely with stakeholders to help prevent and protect our customers from fraud.

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 defines our risk appetite and recommends 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 various risks.

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, the Financial Conduct Authority and law enforcement to support our identification of new and evolving risks.

6. Regulatory and compliance risk

Definition
Regulatory and compliance risk is the risk of failing to understand and comply with relevant laws and regulatory requirements; not keeping regulators informed of relevant issues; not responding effectively to information requests nor meeting regulatory deadlines; or obstructing the regulator.

Appetite
We have no appetite for actions that result in breaches of regulation or for inaction to address systemic process and control failures leading to material non-compliance. Notwithstanding the complexity and volume of the regulatory agenda, we ensure that all mandatory requirements are prioritised with sufficient resources to implement within required timescales in a customer-focused manner.

Mitigation
The following controls and procedures help to mitigate regulatory and compliance risk:
- A clearly defined compliance policy statement (with supporting policy standards) and Regulatory Appetite Statements signed off by the Board.
- Ongoing development, maintenance and reporting of risk appetite measures for regulatory and compliance risk to the Executive Risk Committee and the Board.
- Maintenance of proactive and coordinated engagement with our key regulators.
- Continual assessment of evolving regulatory requirements, including regulatory business plans and thematic reviews.
- Consideration of regulatory requirements in the context of product and proposition development and associated appropriate governance.
- Oversight of key regulatory implementations, including PSD2.
- Oversight of regulatory and compliance risks and issues in relevant governance bodies.
- Ongoing review and tracking of known regulatory and compliance issues and remediation actions being taken.
- A risk-based assurance framework, designed to monitor compliance with regulation and assess customer outcomes.

Our Board, Risk Oversight Committee and Executive Committee (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
Regulatory and compliance risks are measured against a defined set of Board-approved risk appetite metrics relating to regulatory breaches, and past due regulatory implementations and actions. Thresholds are set and form part of the Board-approved Risk Appetite Statement.

5. Regulatory and compliance risk continued

Monitoring

Regulatory and compliance risk is considered by all three lines of defence as part of their oversight and assurance activities. A risk assurance plan, approved by the Executive Risk Committee on an annual basis, independently assesses areas of the control framework underpinning compliance with laws and regulations.

7. Conduct risk

Definition

Conduct risk is the risk of treating customers unfairly and delivering poor outcomes that lead to customer detriment, such as financial loss and/or distress and inconvenience. This can also result in wider adverse impacts, for example, loss of customers, reputational damage, regulatory investigations and/or legal action.

Change since 2019:
Increased

Appetite

We have no appetite for conduct risks that knowingly deliver inappropriate customer outcomes, which may lead to customer detriment. Where inappropriate outcomes are identified, these are remediated quickly to minimise risk and reduce harm to our customers.

Mitigation

Our simple, transparent and fairly-priced products and activities continue to help ensure that conduct risk is minimised. Our colleagues are fully trained in all relevant products and services and these are delivered with exceptional levels of service to customers through all channels, with openness and transparency, supported by robust management controls and quality assurance measures. Our products are reviewed regularly to ensure they continue to meet customer needs and perform as expected. We are committed to ensuring communications are clear, fair and not misleading. We do not use sales incentives in stores, nor is there a perception amongst colleagues that they exist in any unofficial manner.

Make every wrong right

Our service-led business model gives us an inherent advantage over peers. We are committed to doing the right thing for our customers and to making any wrongs right. Where conduct risks are identified, resources and expertise are dedicated to swift remediation action to appropriately mitigate any issues, avoid recurrence and, if detriment has occurred, the scale of the harm is quantified to address this with impacted customers. This is possible because of our clear risk framework which includes defined first line ownership, review stages and challenge by the second line, and assurance from the third line.

In 2019, we made a provision of £12 million for customer remediation, which predominately related to non-compliance with certain requirements to provide SMS warning alerts to customers regarding overdraft charges. The error was subsequently corrected and the Competition and Markets Authority was informed. We pride ourselves on providing exceptional levels of service and we regret the impact on customers. All customers have now been contacted and the remediation project has been completed.

Measurement

We measure conduct risk through Risk Appetite Metrics which are centred around product governance, compliance monitoring, analysis of expressions of dissatisfaction, root cause analysis, 'Voice of the Customer' surveys and reporting through customer treatment forums. Key Risk Indicators are also defined, reported against and escalated to the Risk Oversight Committee. We view the effective management of conduct risk as being evidenced by low levels of poor customer outcomes and evidence of robust controls, meaning that the right internal processes are being followed to deliver these outcomes.

Monitoring

As well as monitoring the trends in the metrics outlined above, we 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 can be defined as the potential loss that we may incur, as a consequence of decisions that could be principally based on the output of models, due to errors in the development, implementation or use of such models. Model risk can lead to financial loss, poor business and strategic decisions, and reputational damage. Model risk covers all models and is not limited to credit risk models.

Appetite

We have only a moderate appetite for risk due to errors in the development, implementation or use of models, which we mitigate via effective governance over the specification and design, implementation and running of our models and over model input data.

Mitigation

Governance

The main mitigant to model risk is the robust governance process we have established. This includes two dedicated model committees:

- Model Oversight Committee – which is the designated committee for the management of model risk.
- Model Governance Committee – which is the technical committee overseeing the model risk life cycle.

Material models are presented to the Model Oversight Committee for approval via the Model Governance Committee, ahead of implementation or model changes.

The Model Oversight Committee defines and approves standards relevant to model risk and recommends policies and model risk appetite to the Risk Oversight Committee for approval on an annual basis. The Model Governance Committee owns the minimum standards and target operating models to mitigate model risk. It 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 the Model Oversight Committee and Model Governance Committee.

Independent review

We have established an independent Model Validation team, which is part of our Prudential Risk function. This is managed by a team of experts, independent from model development. This team is responsible for reviewing model development submissions and maintains a model validation action log to track model risk remediation plans. Models are also subject to internal and external audit as well as regulatory reviews.

Measurement

We measure model risk using a set of model performance indicators which form part of our Key Risk Indicators and are regularly reported and discussed at the Model Governance Committee, Model Oversight Committee, Risk Oversight Committee and Board. On a monthly basis, the Model Governance Committee reviews any material validation actions and tracks their closure.

Monitoring

A dedicated Model Monitoring team is responsible for assessing the ongoing performance of credit risk models against pre-specified tolerances approved by the Model Governance Committee as part of model monitoring standards.

Model performance is regularly monitored, and results are discussed both at the Model Governance Committee and Model Oversight Committee, 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 Model Governance Committee, however, this monitoring is undertaken by the appropriate user areas rather than by the Model Monitoring team.

9. Capital risk

Definition
Capital Risk is the risk that we fail to meet minimum regulatory capital (and MREL) requirements. Management of capital is essential to the prudent management of our balance sheet, ensuring our resilience under stress and the maintenance of the confidence of our current and potential creditors (including bondholders, the bond market, and customers) and key stakeholders in the pursuit of our business strategy.

Appetite
We have a low appetite for Capital Risk and our aim is to maintain a surplus of capital resources above regulatory requirements.

Mitigation
We manage our capital risk via our Capital Adequacy Framework which includes policies, strategy, limit setting, continuous monitoring and stress testing. Our ICAAP is a key component of this framework and is used to analyse material risks and assess our strategy and objectives under various stress scenarios. Capital ratios continued to be maintained within Board risk appetite and regulatory requirements throughout 2020.

Sustainable profit growth
The main mitigation to capital risk is the sustainable generation of additional capital through the accumulation of profits. The Board and Executive Committee are focused on ensuring the successful delivery of the strategic plan to ensure the return to sustainable profitability.

Balance sheet optimisation
Another key mitigation that we can use to manage capital risk is the efficient deployment of our existing capital resources. One of our strategic priorities is improving our balance sheet optimisation to ensure we maximise our risk-adjusted returns whilst remaining above regulatory requirements. As part of this approach we executed a sale of a portfolio of residential mortgages in December 2020 which increased our MREL resources, through a combination of reducing our RWAs and the recognition of a gain on sale.

Raising of additional capital
As we grow we need to raise additional regulatory capital to support lending growth. The ability to raise additional capital, as well as the associated cost, is dependent upon market conditions and perceptions. The sale of the mortgage portfolio removed the need for us to raise additional capital in the near term.

Measurement
We measure our capital resources in line with regulatory requirements. In order to appropriately manage our capital resources, we produce regular reports on the current and forecasted level of capital for the Board and the Executive Leadership Team. This includes the undertaking of routine stress testing on an ongoing basis.

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.

The ICAAP is used to assess the adequacy and efficiency of our capital resources required to support our business model.

Monitoring

We consider both short-term forecasts and medium-term plans, and our overall agreed risk appetite.

We also develop appropriate strategies under market stress conditions to manage those risks to capital and consider both past events and customer behaviour to inform our analysis, and to validate our robustness. This process is used to ensure that we apply appropriate management buffers to regulatory capital requirements in line with risk appetite.

We manage and monitor capital in accordance with prudential rules issued by the PRA and FCA, in line with the EU Capital Requirements Directive, in addition to our own internal reporting measures. 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; and the recent PRA consultation CP17/20 (CRD V: Further Implementation) detailing the transitional changes in the UK regulatory framework required as a result of the exit from the European Union.

Table P: Capital resources

Audited	31 December 2020 £'million	31 December 2019 £'million
Ordinary share capital	**–**	–
Share premium	**1,964**	1,964
Retained earnings	**(694)**	(392)
Other reserves	**19**	11
Intangible assets	**(254)**	(168)
Other regulatory adjustments	**157**	12
Total Tier 1 capital (CET1)	**1,192**	1,427
Debt securities (Tier 2)	**249**	249
Total Tier 2 capital	**249**	249
Total regulatory capital	**1,441**	1,676

Emerging risks

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

We consider emerging risks to be evolving threats which cannot yet be quantified, with the potential to significantly impact the Bank's strategy, financial performance, operational resilience and/or reputation. The emerging risks are continually assessed and reviewed through a horizon scanning process, with escalation and reporting to the Board as necessary. The horizon scanning process fully considers all relevant internal and external factors and is designed to capture those risks which are present but have not yet fully crystallised, as well as those which are expected to crystallise in the future.

Macroeconomic environment

The full extent of the economic impacts from COVID-19 are yet to be seen. The duration and depth of the downturn is uncertain and risks to credit and margin performance are expected, with significant disruption to both supply and demand already occurring. Increasing levels of unemployment could impact customers' ability to repay their lending. The efficacy of monetary and fiscal policy, and the speed and ability with which the UK can return to 'normal' operating conditions, will determine the overall economic impact for the UK.

Mitigating actions

We continue to monitor economic and political developments in light of the ongoing uncertainty, considering potential consequences for our customers, products and operating model. We actively monitor our credit portfolios and undertake robust internal stress testing to identify sectors that may come under stress as a result of an economic slowdown in the UK.

Climate risk

There is significant uncertainty around the time horizon over which climate risks will materialise, as well as the exact way in which they will occur. Climate risk is classified as a cross-cutting risk type that manifests through other principal risks – primarily strategic risk, credit risk and operational risk. We are exposed to physical, transition and reputation risks arising from climate change.

Our mortgage portfolio represents a significant proportion of our customer lending. Increases in extreme variability in weather patterns may lead to increased incidence and severity of physical risks which, in addition to the disruption felt by customers, can lead to a decrease in the valuations of property taken as collateral to mitigate credit risk. In addition, tightening minimum energy efficiency standards for domestic buildings could impact the value of mortgaged properties or the ability of borrowers to service debt. We have low levels of lending to carbon-related assets, however, we may be exposed to future transition risks through the business portfolio.

Mitigating actions

The CRO has Senior Manager Responsibility for our approach to managing financial risks from climate change. We continue to consider climate change in our Risk Management Framework, in line with our plan to align to regulatory expectations. The Executive Risk Committee has responsibility for overseeing our exposures and approach to managing the financial risks from climate change. The Committee will receive regular updates on progress against the plan through the Bank Risk Report and special papers.

Analysis of current river and sea flood risk to properties within the mortgage portfolio has been undertaken as an initial step in assessing the physical risk to our lending. Scenario analysis work will be undertaken to consider the longer-term impacts, as well as the high degree of uncertainty. Transition risk within the mortgage portfolio will also be considered with an assessment of the energy efficiency of properties and we intend to use this information to support our customers to 'green' their homes. An assessment of sectors (and sub-sectors) that may have a higher likelihood of being impacted by transition risks from moving to a lower carbon environment has been performed, to increase understanding of the possible risks facing our customers, and support prioritisation of areas where further analysis is required. Building scenario analysis capability is a key component of work planned for 2021.

Regulatory change

The suite of government support measures introduced in reaction to the economic pressures created by COVID-19 are complex and nuanced. Any sudden or unexpected change to the rules and regulations governing the measures could create material market disruption, requiring large-scale prioritisation decisions in a fast-paced environment. Beyond COVID-19, there is continued evolution of the regulatory landscape and the requirement to respond to ongoing prudential and conduct driven initiatives.

Mitigating actions

We continue to monitor emerging regulatory initiatives to identify potential impacts on our business model and ensure we are well placed to respond with effective regulatory change management. We continue to work with regulators to ensure we meet all regulatory obligations, with identified implications of upcoming regulatory activity incorporated into the strategic planning cycle.

Digitisation

COVID-19 has accelerated the digitisation of the banking industry in the space of a few months and is likely to lead to rapid change over the coming years as the industry rapidly adapts to customers' evolving behaviours. This is spurring an acceleration of investment and delivery by both incumbent banks and neo-banks to provide enhanced digital propositions to customers in both the consumer and business markets.

Mitigating actions

The Bank's strategy had always been predicated on new and exciting digital propositions, with the implications of the pandemic both supporting that ambition, but also accelerating the timeframe for delivery. Our rapid response to the pandemic has demonstrated our ability to implement change and digital solutions swiftly. We are therefore continuously evaluating the timetable and investment profile of our strategy. We are continuing with our investment and digital development in the near term to position us for the future.

3. Capital Resources

Throughout 2020, 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 2020, our capital base was made up of £1,192 million (31 December 2019: £1,427 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.

Tier 2 Capital

Tier 2 capital is £249 million (31 December 2019: £249 million). Tier 2 capital consists of Fixed Rate Reset Callable Subordinated Notes due in 2028.

The details of the main features of these capital instruments can be found below.

Capital composition

Table 3 summarises the composition of regulatory capital.

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 2020 £'million	31 December 2019 £'million
	Capital Resources		
1	Capital instruments and the related share premium accounts	**1,964**	1,964
	Of which: ordinary shares	**–**	–
2	Retained earnings	**(694)**	(392)
3	Accumulated other comprehensive income (and other reserves)	**19**	11
6	**Statutory Total Equity per Financial Statements**	**1,289**	1,583
	Regulatory Capital adjustments		
7	Additional value adjustments (negative amount)	**(1)**	–
8	Intangible assets (net of related deferred tax liability)	**(249)**	(164)
	Add-back of software assets	**75**	–
10	Deferred tax assets that rely on future profitability excluding those arising from temporary differences	**(12)**	–
	IFRS 9 transitional arrangements	**91**	8
28	**Total regulatory adjustments to CET1**	**(96)**	(156)
29	**Total regulatory CET1 capital**	**1,192**	1,427
45	**Tier 1 capital**	**1,192**	1,427
	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**	**1,441**	1,676
60	**Total risk-weighted assets**	**7,957**	9,147
	Capital ratios and buffers		
61	CET1	**15.0%**	15.6%
62	Tier 1	**15.0%**	15.6%
63	Total capital	**18.1%**	18.3%
64	Institution specific buffer requirement[1]	**2.5%**	3.5%
65	*Of which: capital conservation buffer requirement*	**2.5%**	2.5%
66	*Of which: countercyclical buffer requirement*	**0.0%**	1.0%

1. Capital conservation buffer plus countercyclical buffer requirement.

Pillar 3 continued

3. Capital Resources continued

Table 4: 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

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 and other capital instruments 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')

Metro Bank is required to meet an interim MREL requirement of 18% of RWAs plus a 2.5% buffer and end-state MREL from 1 January 2023. Total capital plus MREL ratio of 22.4% as at 31 December 2020 compares to our minimum interim MREL requirement of 20.5%. In the second half of the year the Bank made use of the buffer allowance but a £3.1 billion sale of residential mortgages in December 2020 increased the Bank's total capital plus MREL resources by 4% (recognised over 2020 and 2021), removing the need to raise additional capital in the near term, as well as allowing us to continue to shift our product portfolio towards higher yielding segments.

Leverage ratio

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. It is calculated as tier 1 capital divided by adjusted balance sheet exposure.

We actively monitor and manage leverage:

- 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; and
- leverage is regularly reported to the Board, and included within all business plans.

Our leverage ratio at 31 December 2020 was 5.6% (31 December 2019: 6.6%) and was above the regulatory minimum of 3% at all times during 2020. Tables 5 and 6 provide more detail 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 reflected a reduction in Tier 1 capital due to the loss made by the Group during 2020.

3. Capital Resources continued

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

		31 December 2020 £'million	31 December 2019 £'million
1	**Total assets as per published financial statements**	**22,579**	21,400
4	Adjustments for derivative financial instruments	**23**	15
5	Adjustments for securities financing transactions ('SFTs')[1]	**3**	7
6	Adjustments for off-balance sheet items	**249**	255
7	Other adjustments[2]	**(1,643)**	(171)
8	**Total leverage ratio exposure**	**21,211**	21,506

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.
2. Includes loans under the Bounce Back Loan Scheme ('BBLS'), which amounted to £1,353 million at 31 December 2020.

Table 6: LRCom - Leverage ratio common disclosure

		31 December 2020 £'million	31 December 2019 £'million
	On-balance sheet exposures (excluding derivative and SFTs)		
1	On-balance sheet items (excluding derivatives, SFTs and fiduciary assets, but including collateral)	**21,197**	21,393
2	(Asset amounts deducted in determining Tier 1 capital)	**(261)**	(164)
3	Total on-balance sheet exposures (excluding derivatives, SFTs and fiduciary assets)	**20,936**	21,229
	Other off-balance sheet exposures		
	Derivative Exposures	**23**	15
	Securities Financing Transaction	**3**	7
17	Off-balance sheet exposures at gross notional amount	**790**	710
18	(Adjustments for conversion to credit equivalent amounts)	**(541)**	(455)
19	Other off-balance sheet exposures	**–**	–
	Capital and total exposures		
20	Tier 1 capital	**1,192**	1,427
21	Total leverage ratio exposures	**21,211**	21,506
	Leverage ratio		
22	Leverage ratio	**5.6%**	6.6%

Application of transitional arrangements for IFRS 9

Metro Bank has elected to apply IFRS 9 transitional arrangements and for 2020 the rules allowed for an add-back to obtain a capital relief equal to 70% of the impairment provisions recognised on 1 January 2018. The COVID-19 regulatory measures finalised in June 2020 allowed for 100% relief of stage 1 and stage 2 impairment provisions recognised since 1 January 2020.

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 2020 £'million	31 December 2019 £'million
	Available capital (amounts)		
1	CET1 capital	**1,192**	1,427
2	CET1 capital as if IFRS 9 or analogous ECLs transitional arrangements had not been applied	**1,101**	1,418
3	Tier 1 capital	**1,192**	1,427
4	Tier 1 capital as if IFRS 9 or analogous ECLs transitional arrangements had not been applied	**1,101**	1,418
5	Total capital	**1,441**	1,676
6	Total capital as if IFRS 9 or analogous ECLs transitional arrangements had not been applied	**1,350**	1,668
	Risk-weighted assets (amounts)		
7	Total risk-weighted assets	**7,957**	9,147
8	Total risk-weighted assets as if IFRS 9 or analogous ECLs transitional arrangements had not been applied[1]	**7,952**	9,141
	Capital ratios		
9	CET1 (as a percentage of risk exposure amount)	**15.0%**	15.6%
10	CET1 (as a percentage of risk exposure amount) as if IFRS 9 or analogous ECLs transitional arrangements had not been applied[1]	**13.9%**	15.5%
11	Tier 1 (as a percentage of risk exposure amount)	**15.0%**	15.6%
12	Tier 1 (as a percentage of risk exposure amount) as if IFRS 9 or analogous ECLs transitional arrangements had not been applied[1]	**13.9%**	15.5%
13	Total capital (as a percentage of risk exposure amount)	**18.1%**	18.3%
14	Total capital (as a percentage of risk exposure amount) as if IFRS 9 or analogous ECLs transitional arrangements had not been applied[1]	**17.0%**	18.2%
	Leverage ratio		
15	Leverage ratio total exposure measure	**21,211**	21,506
16	Leverage ratio	**5.6%**	6.6%
17	Leverage ratio as if IFRS 9 or analogous ECLs transitional arrangements had not been applied	**5.2%**	6.6%

1. IFRS 9 transitional impact to RWAs also updated for 2019.

4. Capital Requirements

4.1 Minimum capital requirements

The Bank adheres to regulatory minimum capital requirements, and maintains adequate headroom above these minima, as defined by our ICAAP process. Our CET1 ratio for 31 December 2020 was 15.0% (31 December 2019: 15.6%), total capital ratio was 18.1% (31 December 2019: 18.3%), and regulatory leverage ratio was 5.6% (31 December 2019: 6.6%).

4.2 Pillar 1

We have applied the Standardised Approach to measure credit risk RWAs and the BIA to measure operational risk RWAs. Under Basel III, we must set aside capital equal to 8% of our total risk-weighted assets to cover our Pillar 1 capital requirements. 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.

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).

Table 8 sets out our RWAs and Table 9 sets out our capital requirements.

Table 8: EU OV1 – Overview of risk-weighted assets

		RWAs		Minimum capital requirements	
		31 December 2020 £'million	31 December 2019 £'million	31 December 2020 £'million	31 December 2019 £'million
1	**Credit risk (excluding counterparty credit risk (CCR))**	**7,251**	8,591	**580**	687
2	Of which the standardised approach	**7,251**	8,591	**580**	687
6	**CCR**	**7**	5	**1**	–
7	Of which mark-to-market	**5**	4	**1**	–
12	Of which CVA	**2**	1	**–**	–
19	Market Risk	**14**	5	**1**	1
20	Of which foreign currency risk	**14**	5	**1**	1
23	**Operational risk**	**686**	546	**55**	44
24	Of which basic indicator approach	**686**	546	**55**	44
27	Amounts below the thresholds for deduction (subject to 250% risk weight)	**–**	–	**–**	–
29	**Total**	**7,957**	9,147	**637**	732

4. Capital Requirements continued

Table 9: Capital requirements

Minimum requirements	31 December 2020	
	CET1	Total Capital
Pillar 1	4.5%	8.0%
Pillar 2A	0.6%	1.0%
Total capital requirement ('TCR')	5.1%	9.0%
Capital conservation buffer	2.5%	2.5%
UK countercyclical capital buffer	0.0%	0.0%
Total (excluding PRA buffer, if applicable)	7.6%	11.5%

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, Metro Bank is required 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 2020, the capital conservation buffer was 2.5%. This is the highest level required under the current rules.

4. Capital Requirements continued

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 2020 the UK CCyB was set to 0%. The figures shown in Table 11 (2020: 0.0%, 2019: 1.0%) represent the weighted average of CCyB's issued by various national bodies and exposures in those countries.

In March 2020, the Bank of England reduced the UK countercyclical buffer from 1% to 0% with immediate effect in response to the pandemic.

The geographical distribution of our credit exposures relevant for the calculation of its countercyclical capital buffer is disclosed in the tables 10 and 11.

Table 10: Countercyclical Capital Buffer

	31 December 2020						
	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	**13,050**	**1,611**	**517**	**19**	**536**	**0.998**	**0%**
North America	**–**	**–**	**–**	**–**	**–**	**0.000**	**0%**
Other European Countries	**101**	**–**	**1**	**–**	**1**	**0.002**	**0–1%**
Rest of the World	**4**	**–**	**–**	**–**	**0**	**0.001**	**0–1%**
Total	**13,155**	**1,611**	**518**	**19**	**537**	**1.000**	

	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	

Table 11: Amount of institution-specific countercyclical capital buffer

		31 December 2020 £'million	31 December 2019 £'million
010	Total risk exposure amount	**7,957**	9,147
020	Institution-specific countercyclical buffer rate	**0.0%**	0.99%
030	**Institution-specific countercyclical buffer requirement**	**–**	90

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.

O-SII buffer

The regulator has introduced an 'other' systemically important institutions ('O-SII') buffer to replace the function currently performed by the systemic risk buffer ('SRB'). The O-SII capital requirement is specific to ring-fenced banks and building societies within its scope.

This buffer is not applicable as we do not meet the definition of an O-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 2020 has increased by £1.2 billion while RWAs have fallen by £1.3 billion. The increase in exposures was driven by an increase in cash over the period, however the cause of the swing in the movement of exposures and RWAs was primarily due to the £3.1 billion sale of our residential mortgages, as we have replaced mortgages (which were being risk-weighted at 35%) with cash (risk-weighted at either 0%, for amounts placed in the Bank of England, or 20%).

5. Credit Risk continued

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

	31 December 2020			
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	**5,131**	**4,132**	**–**	**–**
Institutions	**2,767**	**846**	**553**	**44**
Corporates	**521**	**713**	**406**	**33**
Of which: SME	**462**	**564**	**371**	**30**
Retail	**572**	**577**	**376**	**30**
Of which: SME	**301**	**370**	**174**	**14**
Secured by mortgages on immovable property	**9,895**	**12,132**	**4,338**	**347**
Covered bonds	**860**	**801**	**86**	**7**
Claims on institutions and corporates with a short-term credit assessment	**–**	**–**	**–**	**–**
Securitisation Position	**1,611**	**1,684**	**240**	**19**
Exposure at default	**247**	**218**	**248**	**20**
Items associated with particularly high risk	**14**	**19**	**21**	**2**
Other Exposures	**1,045**	**1,006**	**987**	**79**
Total	**22,663**	**22,127**	**7,251**	**580**

	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

5.1.2 Geographic distribution of credit risk exposures

Our credit risk exposures as at 31 December 2020 and 31 December 2019 by geography are detailed in the table below.

Table 13: EU CRB-C - Geographical breakdown of exposures

	31 December 2020				
Standardised Credit Risk	UK £'million	North America £'million	Other European countries £'million	Rest of the world £'million	Total £'million
Central governments or central banks	**5,027**	**59**	**–**	**–**	**5,131**
Institutions	**2,767**	**–**	**–**	**–**	**2,767**
Corporates	**521**	**–**	**–**	**–**	**521**
Retail	**571**	**–**	**–**	**1**	**572**
Secured by mortgages on immovable property	**9,811**	**–**	**81**	**4**	**9,895**
Covered bonds	**860**	**–**	**–**	**–**	**860**
Claims on institutions and corporates with a short-term credit assessment	**–**	**–**	**–**	**–**	**–**
Securitisation position	**1,611**	**–**	**–**	**–**	**1,611**
Exposure at default	**228**	**–**	**19**	**–**	**247**
Items associated with particularly high risk	**14**	**–**	**–**	**–**	**14**
Other exposures	**1,045**	**–**	**–**	**–**	**1,045**
Total	**22,474**	**59**	**101**	**4**	**22,663**

	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

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. Credit Risk continued

5.1.3 Residual contractual maturity of credit risk exposures

Our exposures as at 31 December 2020 and 31 December 2019 analysed by remaining contractual maturity are detailed in the table below.

Table 14: EU CRB-E - Residual maturity of exposures

	31 December 2020						
Standardised Credit Risk	On demand £'million	Up to 12 months £'million	1-5 years £'million	5-10 years £'million	More than 10 years £'million	Non-defined[1] £'million	Total £'million
Central governments or central banks	**2,789**	**–**	**2,266**	**17**	**59**	**–**	**5,131**
Institutions	**199**	**2,568**	**–**	**–**	**–**	**–**	**2,767**
Corporates	**135**	**87**	**140**	**81**	**78**	**–**	**521**
Retail	**60**	**239**	**123**	**26**	**124**	**–**	**572**
Secured by mortgages on immovable property	**6**	**193**	**1,246**	**1,804**	**6,646**	**–**	**9,895**
Covered bonds	**–**	**198**	**559**	**102**	**–**	**–**	**860**
Claims on institutions and corporates with a short-term credit assessment	**–**	**–**	**–**	**–**	**–**	**–**	**–**
Securitisation position	**–**	**–**	**–**	**–**	**1,611**	**–**	**1,611**
Exposure at default	**17**	**17**	**22**	**66**	**125**	**–**	**247**
Items associated with particularly high risk	**–**	**14**	**–**	**–**	**–**	**–**	**14**
Other exposures	**46**	**119**	**–**	**–**	**–**	**881**	**1,045**
Total	**3,252**	**3,435**	**4,357**	**2,097**	**8,644**	**881**	**22,663**

	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	Non-defined[1] £'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	97	–	–	–	856	1,000
Total	3,318	760	2,163	2,217	12,155	856	21,469

1. Includes leased and all other fixed assets.

5.1.4 Industry distribution of credit risk exposures

Our exposures at 31 December 2020 and 31 December 2019 analysed by industry are detailed below.

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

	31 December 2020						
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	213	16	49	146	–	353	25
Institutions	–	–	–	–	–	–	–
Corporates	1	1	38	16	–	65	–
Retail	3	1	18	3	–	13	1
Secured by mortgages on immovable property	52	27	180	311	7	46	9
Covered bonds	–	–	–	–	–	–	–
Claims on institutions and corporates with a short-term credit assessment	–	–	–	–	–	–	–
Securitisation position[1]	–	–	–	–	–	–	–
Exposure at default	1	–	6	18	–	7	–
Items associated with particularly high risk	11	–	–	–	–	–	–
Other exposures	–	–	–	–	–	–	–
Total	281	45	292	494	8	484	36

	31 December 2020							
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	160	45	163	–	87	3,609	265	5,131
Institutions	–	–	–	–	2,767	–	–	2,767
Corporates	102	8	13	19	179	–	78	521
Retail	19	2	4	271	2	–	234	572
Secured by mortgages on immovable property	2,056	35	80	6979	31	–	82	9,895
Covered bonds	–	–	–	–	860	–	–	860
Claims on institutions and corporates with a short-term credit assessment	–	–	–	–	–	–	–	–
Securitisation position[1]	–	–	–	–	1,611	–	–	1,611
Exposure at default	71	6	6	128	–	–	5	247
Items associated with particularly high risk	3	–	–	–	–	–	–	14
Other exposures	–	–	–	–	46	–	1000	1,045
Total	2,412	96	266	7,396	5,583	3,609	1,663	22,663

1. Metro Bank invests in certain Residential Mortgage Backed Securities ('RMBS').

5. Credit Risk continued

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

Standardised Credit Risk	31 December 2019 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[1]	–	–	–	–	–	–	–
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	91	31	279	331	34	163	12

Standardised Credit Risk	31 December 2019 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[1]	–	–	–	–	134	3,066	–	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	3,066	1,384	21,469

1. 2019 exposure to Central governments or central banks updated from Construction to Public admin & finance.

5.1.5 Charges for specific credit risk adjustments

Our charges for specific credit risk adjustments at 31 December 2020 and 31 December 2019 analysed by portfolio are detailed below.

Table 16: Expected credit loss expense

	31 December 2020 £'million	31 December 2019 £'million
Retail mortgages	**18**	(3)
Consumer lending	**12**	4
Commercial lending (excluding asset and invoice finance)	**87**	–
Asset and invoice finance	**3**	(1)
Expected credit losses included within gains and sale of assets	**6**	8
Held for sale assets	**1**	–
Write-offs and other movements	**–**	4
Total expected credit loss expense	**127**	12

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 appetite is reviewed regularly. This section provides further detail on the specific areas where we are exposed to credit risk.

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 our credit reference agency, which provide detailed insight into the applicant's score, credit history and indebtedness, and which is carefully reviewed by the underwriters.

The dynamic LTV is referred to as the Debt to Value ('DTV'), and the average DTV of the residential mortgage loan book is 56% (31 December 2019: 59%). We perform an indexed revaluation of mortgage collateral at least on an annual basis.

We 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 to ensure the property is appropriately secured to cover any losses in the event of default, where the asset has to be recovered and sold. Valuations are performed by highly experienced and qualified external firms. Valuers provide commentary on the tenancy/letting of properties where commercial mortgages are connected to an investment property transaction.

Financial analysis is undertaken for all loans and other forms of security are often obtained, such as a personal guarantee.

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

5. Credit Risk continued

5.2.3 Non-performing Loans and Provisioning

Past due definition

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.

Impaired definition

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.

In line with the requirements of IFRS 9, the Bank does not have any general provisions and all provisions are therefore captured as specific credit risk adjustments.

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 an expected credit loss to be recognised for underperforming loans. This is considered based on a staging approach presented in Table 16.

Table 17: 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 macroeconomic 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 macroeconomic 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 macroeconomic 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 recognised as a loss allowance.

For details on IFRS 9 Expected Credit Losses, please refer to Note 31 of our 2020 Annual Report and Accounts.

At the end of 2020 we held an ECL provision of £154 million (31 December 2019: £34 million).

5. Credit Risk continued

Table 18: EU CR1-A - Credit quality of exposures by exposure class

	2020			
Standardised Credit Risk	**Defaulted Exposure (Gross carrying values) a £'million**	**Non-Defaulted Exposure (Gross carrying value) b £'million**	**Specific Credit Risk Adjustment c £'million**	**Net Values (a+b-c) £'million**
Central governments or central banks	**–**	**5,131**	**–**	**5,131**
Institutions	**–**	**2,767**	**–**	**2,767**
Corporates	**–**	**619**	**98**	**521**
Retail	**–**	**596**	**24**	**572**
Secured by mortgages on immovable property	**–**	**9,920**	**25**	**9,895**
Covered bonds	**–**	**860**	**–**	**860**
Claims on institutions and corporates with a short-term credit assessment	**–**	**–**	**–**	**–**
Securitisation position	**–**	**1,611**	**–**	**1,611**
Exposure at default	**247**	**–**	**–**	**247**
Items associated with particularly high risk	**–**	**14**	**–**	**14**
Other exposures	**–**	**1,045**	**–**	**1,045**
Total	**247**	**22,564**	**147**	**22,663**

	2019			
Standardised Credit Risk	**Defaulted Exposure (Gross carrying values) a £'million**	**Non-Defaulted Exposure (Gross carrying value) b £'million**	**Specific Credit Risk Adjustment c £'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

Table 19: Loss allowance under IFRS 9

Loss allowance	2020 Stage 1 £'million	2020 Stage 2 £'million	2020 Stage 3 £'million	2020 POCI £'million	2020 Total £'million
1 January	**(9)**	**(5)**	**(20)**	**–**	**(34)**
Transfer to/(from) stage 1	**(1)**	**1**	**–**	**–**	**–**
Transfer to/(from) stage 2	**1**	**(1)**	**–**	**–**	**–**
Transfer to/(from) stage 3	**–**	**2**	**(2)**	**–**	**–**
Net re-measurement due to transfers	**1**	**(43)**	**(34)**	**–**	**(76)**
New lending	**(11)**	**(16)**	**(3)**	**–**	**(30)**
Transfer to held for sale	**1**	**–**	**–**	**–**	**1**
Derecognitions	**4**	**2**	**4**	**–**	**10**
Changes to model assumptions	**(16)**	**(9)**	**–**	**–**	**(25)**
31 December	**(30)**	**(69)**	**(55)**	**–**	**(154)**

Loss allowance	2019 Stage 1 £'million	2019 Stage 2 £'million	2019 Stage 3 £'million	2019 POCI £'million	2019 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)	–	(34)

Table 20: EU CR2-B – Changes in the stock of defaulted and impaired loans and debt securities

	Gross carrying amount value defaulted exposures 2020 £'million	Gross carrying amount value defaulted exposures 2019 £'million
As at 1 January	**115**	58
Loans and debt securities that have defaulted or impaired since the last reporting period	**185**	70
Returned to non-defaulted status	**(7)**	(8)
Amounts written off	**(36)**	(22)
Other changes	**–**	17
As at 31 December	**257**	115

The increase in the gross carrying amount of defaulted exposures from FY 2019 to FY 2020 is primarily driven by customers who have received temporary COVID-19 support measures and now require further forbearance support which has been classified as meeting the unlikeliness to pay criteria in the definition of default.

5. Credit Risk continued

Table 21: Impaired exposures and past due exposures by industry

	31 December 2020		31 December 2019	
	Past due but not impaired £'million	Impaired £'million	Past due but not impaired £'million	Impaired £'million
Personal	**68**	**133**	66	67
Hospitality	**7**	**28**	2	9
Develop, Buy, Sell and Rent Real Estate	**28**	**58**	74	6
Health and Social Work	**3**	**6**	17	5
Construction	**0**	**4**	1	18
Legal, Accounting, Consultancy	**1**	**0**	3	–
Other	**0**	**27**	2	10
Total	**109**	**257**	165	115

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.

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.

The guarantees used as part of the Bank's credit risk mitigation techniques were strictly limited to certain US government backed RMBS i.e. Ginnie Mae. During 2020, the Bank made use of the UK Government backed Coronavirus Business Interruption Loan Scheme ('CBILS') and Bounce Back Loan Scheme ('BBLS'). The Bank does not make use of on- or off-balance sheet netting.

Table 22: Total exposures covered by credit risk mitigation

31 December 2020	Exposure value covered by eligible financial collateral £'million	Exposure value covered by guarantees £'million	Total exposure value covered by credit risk mitigation £'million
Institutions	196	–	196
Corporate	–	79	79
Retail	–	1,388	1,388
Securitisation	–	59	59
Total credit risk mitigation	**196**	**1,526**	**1,722**

5.3 Credit risk – liquidity portfolio and investment

Credit risk of bank and Treasury counterparties is managed through our Treasury Dealing Policy (and the Bank's Credit Risk 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'). The external ratings from these institutions are mapped to a prescribed credit quality step assessment scale that in turn produces standard risk weightings.

The exposure classes for which ECAI is used and the exposure values associated with each credit quality step are provided in Table 23.

Table 23: Exposure by credit quality step

	31 December 2020 £'million	31 December 2019 £'million
Central governments and central banks		
Credit quality step 1	**2,345**	449
Total	**2,345**	449
Institutions		
Credit quality step 3	**2,568**	–
Total	**2,568**	–
Corporates		
Credit quality step 1	**63**	–
Credit quality step 2	**–**	67
Total	**63**	67
Covered bonds		
Credit quality step 1	**860**	469
Total	**860**	469
Securitisation		
Credit quality step 1	**1,611**	1,580
Total	**1,611**	1,580

The Bank performs its internal stress testing to ensure that our Treasury credit risk exposures are in line with policy. Credit proposals are presented by Treasury and sent to Treasury Risk for challenge/approval and thereafter, ALCO members for credit approval.

6. Operational Risk

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 seek 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 evaluated and quantified through stress scenarios, which are then utilised in the Bank's operational risk capital assessment.

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.

Operational risk RWAs are calculated using the Basic Indicator Approach ('BIA'). This is based on a three-year average of net income.

Table 24: Operational risk RWAs

Operational risk RWAs	2020 £'million	2019 £'million
As at 1 January	**546**	370
Movement	**140**	176
As at 31 December	**686**	546

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 International Swaps and Derivatives Association ('ISDA') master netting agreements, supported by Credit Support Annexes ('CSA'). The Bank clears interest rate swaps through the central counterparty London Clearing House ('LCH').

We assign counterparty credit limits based on the credit assessment and rating of the counterparty and monitor exposures against these limits on a daily basis. Our exposure to counterparty credit risk is 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 for counterparty credit risk are disclosed in tables 25 and 26.

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

Table 25: 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 2020	**6,950**	**7,095**	**25,569**	**5,114**	**409**
31 December 2019	1,765	8,042	22,029	4,406	352

Table 26: EU CCR2 – Credit Valuation Adjustment

Credit Valuation Adjustment	Total Exposure Value £000's	RWA £000's	Capital Requirement £000's
31 December 2020	**22,912**	**1,848**	**148**
31 December 2019	9,807	1,226	98

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.

Netting agreements

We restrict our exposure to credit losses by entering into netting arrangements with counterparties with whom we undertake derivative transactions. 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 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 ISDA master agreements, and CSAs, around collateral arrangements attached to those ISDA agreements. The Bank has entered into ISDA/FIA cleared derivatives execution agreements to facilitate the clearing of relevant derivatives with central counterparties.

8. Liquidity and Funding Risk

8.1 Liquidity risk management

Liquidity risk is the risk that we fail to meet our short-term obligations as they fall due. Funding risk is the risk that the Bank cannot fund assets that are difficult to monetise at short notice (i.e. illiquid assets) with funding that is behaviourally or contractually long term (i.e. stable funding). The impact of COVID-19 has resulted in an overall improvement to the Bank's overall liquidity profile through improved deposit balances and participation in the Bounce Back Loan Scheme, with clients placing funds drawn-down on deposit, prior to their utilisation. Our LCR has remained strong throughout the year, ending 2020 at 187% (2019: 197%).

Risk Framework

We have established an Overall Liquidity Adequacy Framework in order to ensure that we adhere 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; and
- determine the Board's risk appetite.

8. Liquidity and Funding continued

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.

Further details on our approach to mitigation, measurement, monitoring recovery plan and risk appetite can be found in the Risk Report starting on page 22.

8.2 Liquidity coverage ratio

Table 26 provides a summary of our LCR. Our LCR as at 31 December 2020 was 187% (31 December 2019: 197%) which comfortably exceeds the Basel Committee's minimum requirement of 100% for the time period.

Table 27: EU LIQ1 – Liquidity coverage ratio

	31 December 2020 £'million	31 December 2019 £'million
Total HQLA	**3,762**	3,356
Total net cash outflow	**2,011**	1,708
Liquidity coverage ratio	**187%**	197%

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 schemes (TFS and TFSME), third party repurchase agreements and to a lesser extent collateral for derivatives. The Bank has not issued any securitisations.

The Bank's sources of encumbrance and encumbered assets are mostly in GBP, with a small proportion in USD. The Bank considers 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 £2,715 million of mortgage loans as at 31 December 2020 (31 December 2019: £5,562 million[1]), which could provide secured funding as central bank-eligible collateral or as part of a securitisation. The Bank had £1,060 million of fixed and intangible assets as at 31 December 2020 which cannot be encumbered for funding purposes.

We have pledged £5,363 million (2019: £5,809 million) of the financial assets above as encumbered collateral which can be called upon in the event of default. Of this, £1,186 million (2019: £941 million) is made up of high-quality securities and £4,177 million (2019: £4,868 million) is from our own loan portfolio.

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 which require firms to disclose based on the median of each calendar quarter. Template B is not applicable as we do not have any received collateral.

1. 2019 figure has been updated to correct a typographical error.

Table 28: Encumbered and unencumbered assets (Template A)

		2020							
		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 December	£'million	£'million	£'million	£'million	£'million	£'million	£'million	£'million
10	Assets of the reporting institution	**5,682**	**705**			**16,463**	**4,322**		
30	Equity instruments	**–**	**–**			**–**	**–**		
40	Debt securities	**984**	**665**	**979**	**663**	**2,176**	**1,441**	**2,180**	**1,449**
50	*Of which: covered bonds*	**–**	**–**	**–**	**–**	**744**	**744**	**741**	**741**
60	*Of which: Asset-backed securities*	**426**	**140**	**418**	**140**	**1,388**	**735**	**1,390**	**775**
70	*Of which: issued by general governments*	**211**	**211**	**215**	**215**	**201**	**196**	**202**	**201**
80	*Of which: issued by financial corporations*	**743**	**454**	**738**	**448**	**1,857**	**1,255**	**1,861**	**1,248**
120	Other assets[1]	**4,714**	**37**			**14,038**	**2,791**		

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

		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 December	£'million	£'million	£'million	£'million	£'million	£'million	£'million	£'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	4,894	26	–	–	13,860	2,671	–	–

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

Table 29: Sources of encumbrance (Template C)

		31 December 2020		31 December 2019	
		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 December	10 £'million	30 £'million	10 £'million	30 £'million
10	Carrying amount of selected financial liabilities	**4,038**	**5,682**	4,056	5,836

10. Securitisation

We invest in highly rated securitisation issues in eligible, established asset classes to support regulatory liquidity requirements. External credit rating assessments are provided by Fitch, Moody's and S&P (where available) to assess the rating of the positions in which we invest. In line with our liquidity risk appetite, our Treasury Dealing Policy restricts investment activity to senior, high-quality liquid securities in a small number of established, low risk-sectors.

External credit rating assessments are provided by Fitch, Moody's and S&P (where available) to assess the rating of the positions in which we invest.

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. Applying the hierarchy of methods, the Bank has informed the PRA in applying the external ratings based approach ('SEC-ERBA') to all of our rated securitisations.

Table 30 shows the exposure value of purchased securitisations by asset type.

Table 30: Exposure value of purchased securitisations

	Exposure value	
	31 December 2020 £'million	31 December 2019 £'million
Residential Mortgage Backed Securities	**1,611**	1,580

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 Dealing policy by our Treasury function and overseen by Prudential Risk.

11. Other matters

11.1 Economic value of equity 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 and reviewed at least annually through our Market Risk Assessment Process. 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 which are close to limit thresholds 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 and ROC.

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 31: EVE Sensitivity analysis

	Sensitivity of economic value to parallel interest rate shock	
	200bps increase £'million	200bps decrease (not floored at 0) £'million
31 December 2020	17.4	(19.0)
31 December 2019	7.6	(9.3)

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 colleagues are remunerated in a way that supports the strategic goals of the Bank but also remains compliant with regulations.

The Remuneration Committee ('the Committee') reviews the Policy as part of its annual calendar of activities, ensuring it remains aligned with our long-term strategic goals and remains compliant with regulations. The Committee also considers feedback from investors and representative bodies.

The Bank received strong support for our updated Policy at the 2020 Annual General Meeting ('AGM'). However, following the announcement of the Bank's strategic plan in 2020, the Committee felt our approach to remuneration needed to be reconsidered and, as such, we will be seeking shareholders' approval for a new Policy for the following three years at the 2021 AGM.

Throughout the review, the Committee has been mindful of the views of our shareholders on remuneration matters, taking into account feedback given during 2020, especially with regards to our Executive Directors. The review and implementation have been supported by Aon (McLagan) who have a deep understanding of remuneration practices across the financial services sector.

Our approach to remuneration is one of simplicity, we offer colleagues a compensation structure that supports our unique culture and long-term strategy as well as being aligned the shareholder needs. Colleague reward is aligned to their AMAZEING review rating; this shows how colleagues have behaved in line with our culture and values, and also how they have performed against objectives. The Bank's approach to remuneration, in particular variable remuneration, is underpinned by risk principles in our corporate scorecard which discourages unnecessary risk-taking. Our reward principles are to:

- Pay fair salaries and offer strong career and growth opportunities in an AMAZEING culture.
- Encourage all colleagues to be 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.
- Offer a market-competitive approach to variable reward which enables us to attract and retain talent; no excessive cash bonuses or linear incentives which can skew behaviours and encourage unnecessary risk-taking.

12. Remuneration continued

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 32 members of staff as material risk takers in 2020 (2019: 25).

The following groups of individuals have been identified as meeting the criteria for Material Risk Takers:
- Senior Management, Executive Directors, members of the Executive Committee.
- Non-Executive Directors.
- Other colleagues whose activities could have an impact on the Bank's risk profile.

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 quarter 1, once corporate performance is known.

The Committee has not appointed a remuneration advisor but, during 2020, Deloitte LLP and Aon (McLagan) have offered advice to management who have in turn advised 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.

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. Taking into consideration shareholder feedback during 2020, we will be seeking approval for an updated Policy at the 2021 Annual General Meeting. The new policy is more in line with wider market practice and provides greater levels of transparency to all colleagues.

Reward decisions for Executive Directors and members of the wider Executive Committee 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. Subject to the approval of the revised policy at the upcoming AGM, the approach taken for our Material Risk Taker population will differ from that of the wider colleague population.

We offer base salary, variable remuneration and a consistent benefit offering to all colleagues. To align the interests of our Material Risk Taker population with those of our shareholders, it is proposed to offer a long-term deferred share and/or a Long Term Incentive Plan ('LTIP') award to this population, should the revised policy be approved.

Through an annual benchmarking exercise, the Bank ensures salaries remain competitive against peers in the financial services sector. 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 2020 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 an annual bonus. The annual bonus 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.

Where appropriate, and in line with regulatory requirements a proportion of any annual bonus may be deferred (as per the 'deferral and vesting' section below). Annual bonus deferrals will be made under the Deferred Variable Reward Plan ('Deferral Plan'). Deferral levels are set at the time of award and in line with regulatory requirements (see below) taking into account total remuneration for the financial year.

Long-term incentives
The Bank's proposed Long-Term Incentive Plan is designed to align senior colleagues' remuneration with the long-term interests of the Bank and its shareholders. It will reward long-term delivery of the Bank's strategy and growth. Performance conditions will normally be tested over a period of three financial years with the first grant of LTIP in 2021 having a four-year performance period 2021–2024 to align with the delivery of the strategic plan. Subject to the achievement of any performance conditions, awards will vest according to timetables designed to comply with regulatory requirements. The performance conditions will be aligned to the Bank's long-term strategy.

All variable remuneration is subject to malus and clawback.

Deferral and vesting
Variable remuneration deferral levels are set to meet regulatory requirements at time of award. Therefore, Material Risk Takers receiving a variable remuneration award in respect of 2020 performance that exceeds 33% of total pay or total remuneration that exceeds £500,000:
- at least 40% of total variable remuneration is deferred;
- at least 50% of variable remuneration is paid in shares; and
- vested shares are subject to retention periods.

The Committee considers input from the CRO before any deferred awards are released; they 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 10 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 (or 10 years in the case of individuals holding a PRA Senior Manager Function role and where an investigation has commenced) after the date of the awards; and
- requiring variable remuneration award which has been awarded but not yet paid to be forfeited.

12. Remuneration continued

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; and
- 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 colleagues' behaviours and also their 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 CRO 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 tables display the 2020 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 32: Remuneration for material risk takers

	Senior Manager	Material Risk Taker	Total
Number of Material Risk Takers	**25**	**7**	**32**
	£'million	**£'million**	**£'million**
Total fixed remuneration	**4.8**	**0.6**	**5.4**
Variable remuneration (cash)[1]	–	–	–
Variable remuneration (shares)	0.7	–	0.7
Deferred remuneration (cash)	–	–	–
Deferred remuneration (shares)	1.3	–	1.3
Long-term incentive (shares)[2]	–	–	–
Total variable remuneration	**2.0**	**–**	**2.0**
Total remuneration	**6.8**	**0.6**	**7.4**

1. Includes a commencement award of £35,000.
2. Values for 2020 LTIP awards are based on the face value of awards.

Table 33: Special payments to staff

This table shows special payments to staff whose professional activities have a material impact on institutions' risk profile (identified staff)

	Senior Manager	Material Risk Taker	Total
Commencement awards (£'million)	0.0	–	0.0
No. of beneficiaries	1	–	1
Retention awards[1]	0.1	–	0.1
No. of beneficiaries	1	–	1
Termination awards (£'million)	–	0.3	0.3
No. of beneficiaries	–	1	1
Highest award to single beneficiary (£'million)	0.1	0.3	0.3

1. Retention award made to individual prior to being deemed a Senior Manager.

Table 34: Deferred remuneration

	Senior Manager £'million	Material Risk Taker £'million	Total £'million
Deferred remuneration at 1 January 2020	0.4	0.3	0.6
Awarded in the year	–	–	0.1
Performance adjustment in the year	–	–	–
Forfeited in the year	–	0.1	0.1
Paid in the year	–	–	–
Deferred remuneration at 31 December 2020	0.4	0.2	0.6
Of which: vested	0.2	0.1	0.4
Of which: unvested	0.2	–	0.2

12. Remuneration continued

Table 35: Remuneration of EUR 1 million or more per year

	Senior Manager	Material Risk Taker	Total
€2,500,000 – €3,000,000	–	–	–
€2,000,000 – €2,500,000	–	–	–
€1,500,000 – €2,000,000	–	–	–
€1,000,000 – €1,500,000	1	–	1

For the details of our remuneration disclosures, please refer to the 2020 Remuneration Report within our 2020 Annual Report and Accounts.

13. Gender diversity

In line with the Hampton-Alexander Review, we have continued to make progress with gender diversity on our Board. At the date of this report, 33% of Board members were female (2019: 30%). We actively recruit and promote females into positions of leadership with 46% of our Executive Committee ('ExCo') and 38% of the Senior Leadership Team ('SLT') being female. With this, we have exceeded the Hampton-Alexander Review's target of 33% female representation on the ExCo and SLT (direct reports to the Executive Team).

We are also proud signatories of the Women in Finance Charter, which aims to achieve gender balance at all levels across financial services firms.

During 2020 we published our gender pay gap figures for the third 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 2020 Annual Report and Accounts.

We have a range of initiatives focused on creating inclusion and diversity in our environment, which will in turn provide gender diversity in leadership roles.

Our Women on Work Network has a new chair whose objectives are to increase the reach of the network, particularly focusing on supporting women's careers. Our inclusion committees are strengthening their alignment this year, focusing on issues like supporting new parents back to work following parental leave (regardless of gender); using preferred pronouns into email signatures which would create openness, understanding and inclusion around gender and avoid assumptions of binary male/female identification.

We have a number of policies that support gender diversity, we also offer flexible working arrangements and 14 weeks' parental leave for all new parents, regardless of gender.

To support development and recruitment of diverse talent, we provide diverse candidate shortlists to hiring managers, and hiring manager online learning content that increases awareness and skill in fair and unbiased hiring behaviours and decisions. In addition, we offer inclusive leadership online learning, mentoring circles that cover topics such as confidence and authenticity at work, and leadership seminars on key topics and career development.

In 2019, we 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.

Metro Bank plc

metrobankonline.co.uk