PILLAR 3 2018

METRO BANK PLC

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PILLAR 3

Common Equity Tier 1 capital	**£1,171 million**
Risk weighted assets	**£8,936 million**
CET1 ratio	**13.1%**
Regulatory leverage ratio	**5.4%**
Leverage	**6.4%**

During 2018 we retained a robust capital structure supported by a £303 million equity raise and a £250 million Tier 2 debt raise.

We ended the year with Common Equity Tier ('CET1') Capital of £1,171 million which is 13.1% as a percentage of Risk Weighted Assets ('RWAs'). This exceeds our Tier 1 regulatory minimum of 10.6% based on our current capital requirements (excluding any confidential PRA buffers, if applicable). Our Regulatory Leverage ratio is 5.4% and our total capital as a percentage of risk weighted assets is 15.9%.

On 23 January 2019, we announced that we had adjusted the risk weighting of certain commercial loans secured on commercial property and certain specialist buy-to-let loans that had the combined effect of increasing our RWAs by £900 million. Whilst the risk weightings have been adjusted, there is no deterioration in the credit quality of the affected assets. We are learning the lessons from this and will continue to improve our systems and controls around capital and risk-weighted assets.

While these changes have affected our capital surplus, we are satisfied that we have appropriately assessed the credit risk of the loans and we remain comfortable with the strength of our book. We are in the process of implementing changes to our systems and control environment to drive greater assurance in this areas as we continue our growth.

David Arden
Chief Financial Officer

Aileen Gillan
Chief Risk Officer

10 April 2019

1. Executive Summary

1.1 Introduction

The European Union ('EU') Capital Requirements Directive ('CRD') came into effect on 1 January 2007 and was implemented in the UK by the Financial Services Authority ('FSA'). This introduced consistent capital adequacy standards governing how much capital banks must hold to protect their depositors and shareholders, and an associated supervisory framework in the EU based on the Basel II Accord.

The EU implemented the Basel III proposals published in December 2010 through the Capital Requirements Regulation ('CRR') and CRD (together referred to as 'CRD IV') which came into force on 1 January 2014 and is enforced in the UK, together with local implementing rules and guidance, by the Prudential Regulation Authority ('PRA') and Financial Conduct Authority ('FCA'). The rules include disclosure requirements known as 'Pillar 3' which apply to banks, building societies and investment banks. These are designed to promote market discipline through the disclosure of key information about risk exposures and risk management processes. CRD IV also made changes to rules on corporate governance, including remuneration, and introduced standardised regulatory reporting within the EU.

The Basel 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.

1.2 Scope

Metro Bank PLC ("our" or "we") is a UK registered bank that is authorised by the PRA and regulated by the FCA and PRA and is listed on the London Stock Exchange.

We have 2 subsidiaries: SME Invoice Finance Limited and SME Asset finance Limited. Both firms are regulated by the FCA only and are not CRD IV regulated entities. We have applied for, and been granted, permission to use individual consolidation method when producing prudential returns. This means that we include the activities of SME IF and SME AF in our regulatory returns and do not disclose them separately. The basis of consolidation of our subsidiaries is the same for accounting and prudential purposes.

There are not any current or foreseen material practical or legal impediment 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.

1.3 Basis and frequency of disclosures

1.3.1 Purpose and frequency

This document sets out our 2018 Pillar 3 Disclosure, in accordance with the rules laid out in the CRR (Part 8) and our Pillar 3 Policy Document. Our Pillar 3 Disclosures are published annually either concurrently with or subsequently to our Annual Report and Accounts. The purpose of these disclosures is to give information on the basis of calculating Basel III capital requirements and on the management of risks we face.

1.3.2 Regulatory considerations

In December 2016 the European Banking Authority ('EBA') published the final guidelines on the Pillar 3 disclosures (EBA GL 2016/11) which came into effect on 31 December 2017 for Globally Systemically Important Institutions ('G-SII'), Other Systemically Important Institutions ('O-SII') and any other institutions that have been advised by competent authorities to comply with some or all guidance in these guidelines.[1]

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

In January 2018 the EBA published guidelines on transitional arrangements for mitigating the impact of the introduction of IFRS 9 on own funds. The required disclosure can be found in Section 3.4.

1.3.3 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 2018, our financial year end, with comparative figures for 31 December 2017 where relevant.

The disclosures may differ from similar information in our Annual Report and Accounts prepared in accordance with International Financial Reporting Standards ('IFRS'); therefore, the information in these disclosures may not be directly comparable with that information. For the year ending 31 December 2018 we used the Standardised Approach to credit risk and market risk and the Basic Indicator Approach ('BIA') to operational risk.

1. Paragraph 8 of the EBA GL 2016/11 are applicable to all institutions required to comply with some or all disclosure requirements in Part 8 of the CRR

1.4 Exemption from disclosure

1.4.1 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.

No disclosures have been omitted due to their immateriality.

1.4.2 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.

1.4.3 Non-applicable disclosures

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

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

1.5 Changes to disclosure

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

There have been several enhancements since our 2017 report. The key changes include:

- Additional tables have been added in Section 3 Capital Resources, Section 4 Capital Requirement, Section 5 Credit risk, Section 6 Operational Risk, Section 7 Counterparty Credit Risk, Section 8 Liquidity Risk, and Section 9 Asset Encumbrance.
- Governance for these disclosures have been defined in Section 1.7 Review by Board.
- Additional details have been added in Section 2.6 Risk oversight, monitoring and reporting and Section 2.7 Risk hedging and mitigating.

1.6 Key updates of the year

Our total capital position during 2018 was supported by the £250 million qualifying Tier 2 subordinated debt issuance in June 2018, and the £303 million Common Equity Tier 1 ('CET1') capital raise in July 2018. We ended the year with CET1 Capital at 31 December 2018 was £1,171 million, which is 13.1% of Risk Weighted Assets ('RWAs'). This exceeds our Tier 1 regulatory minimum of 10.6% based on our current capital requirements (excluding any confidential PRA buffers, if applicable). Our Regulatory Leverage ratio was 5.4% and our total capital as a percentage of risk weighted assets was 15.9%.

On 23 January 2019, we announced that we had adjusted the risk weighting of certain commercial loans secured on commercial property and certain specialist buy-to-let loans that had the combined effect of increasing our RWAs by £900 million. Whilst the risk weightings have been adjusted, there is no deterioration in the credit quality of the affected assets. We are learning the lessons from this and will continue to improve our systems and controls around capital and risk-weighted assets.

For more details of the impact of RWA adjustment, please refer to Section 12.1 Regulatory Risk

1.7 Review by Board

These disclosures have been subject to internal verification and are reviewed by the Risk Oversight Committee ('ROC') on behalf of the Board. 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.

1.8 Summary of risk profile
Table 1 presents our key metrics.

Table 1: Key Ratios

	31 December 2018	31 December 2017
Common Equity Tier 1 ('CET1') ratio	13.1%	15.3%
Tier 1 capital ratio	13.1%	15.3%
Total capital ratio	15.9%	15.3%
Leverage ratio	5.4%	5.5%
Liquidity Coverage Ratio ('LCR')	139.2%	141.0%

	£'million	£'million
Risk Weighted Assets ('RWAs')	8,936	5,882
Total assets	21,647	16,355

The above ratios include the 2018 profit

2. Risk Management
2.1 Risk management objectives
Our risk and control framework is designed to ensure that:

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

Our unique, pervasive culture supports risk awareness by encouraging every colleague to think about the relationship between their role and our goal of creating FANS whilst growing safely and sustainably; and to be comfortable asking questions when they are not clear about policy to ensure their actions do not result in financial loss, reputational damage or customer detriment.

Our core objective is the effective management of risk to protect depositors, borrowers, shareholders and to ensure that we have adequate capital and liquidity resources.

Our risk management framework is outlined in Sections 2.3 – 2.8, indicating the relevant governance structure and control process.

2.2 Principal risks
Given the nature of the activities we undertake, the principal risks we face are credit risk, market risk, liquidity risk, conduct risk, regulatory risk, operational risk, financial crime risk and model risk. Each risk has a defined risk appetite which is supported though documented policies and overseen by a robust governance process. The principal risks are covered in more detail in Sections 2.4 – 2.7.

- **Credit risk:** The risk of financial loss due to an obliger's failure to meet the terms of any contract or otherwise fail to perform as agreed.
- **Market risk:** The risk that earnings or the economic value of equity will under-perform due to changes in interest rates, foreign exchange rates, or other financial market asset prices. Our ability to manage market risks contributes to our overall capital management.
- **Funding and liquidity risk:** The risk that future financial obligations are not met or future asset growth cannot occur because of an inability to obtain funds at a reasonable price within a reasonable time.
- **Conduct risk:** The risk of treating customers unfairly, and delivering inappropriate outcomes that lead to customer detriment.
- **Regulatory risk:** The risk of financial loss or reputational damage due to regulatory fines or penalties, restriction or suspension of business, or cost of mandatory corrective action as a result of failing to adhere to applicable laws, regulations and supervisory guidance.
- **Operational risk:** The risk of direct or indirect loss from failed or inadequate processes, people or systems, or exposure to external events.
- **Financial Crime risk:** The risk of financial loss or reputational damage due to regulatory fines or penalties, restriction or suspension of business, or cost of mandatory corrective action as a result of failing to comply with prevailing legal and regulatory requirements relating to financial crime (which we define to include internal or external fraud, anti-money laundering/counter terrorist financing, bribery and corruption and sanctions compliance)
- **Model risk:** The risk of potential for negative outcomes from random or systematic errors in model development, input, calculation or use of outputs. Models are always approximations and never perfect and there are therefore risks associated with using them. These risks range from their theoretical basis, the data and methods used in their construction, the economic conditions under which they are developed, and their use.

2.3 Risk management

Board role

The Board is responsible for setting strategy, corporate objectives and risk appetite. The strategy and risk appetite considers the interests of our customers, shareholders and other stakeholders. On the advice of the Risk Oversight Committee ('ROC'), the Board approves the level of risk acceptable under each principal risk category, whilst providing oversight to ensure there is an adequate framework in place for reporting and managing those risks. The Board has delegated responsibility for reviewing the effectiveness of this framework to the ROC.

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

The Board has delegated responsibility for reviewing the effectiveness of internal controls to the Audit Committee. This committee monitors and considers the internal control environment, internal and external audits and risk assurance, and is assisted in its oversight role by our Internal Audit function. Internal Audit carries out both regular and ad-hoc reviews of risk management controls and procedures and reports the results to the Audit Committee. The Audit Committee will review the Internal Audit reviews of the RWA control enhancement programme in 2019. The Director of Internal Audit's reporting line is to the Chairman of the Audit Committee, with a dotted line to the CEO, and therefore supports the function's independence.

Chief Risk Officer and the Risk Function

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

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

Risk management policies

We've established our risk management policies to identify and analyse the risks we face, to set appropriate risk limits and controls, and to monitor risks and adherence to limits. The Risk team regularly reviews these policies and controls to verify compliance and to reflect changes in market conditions and our activities. We use training and management standards and procedures to develop a robust and effective control environment – one where all colleagues understand their roles and obligations.

For the details of our risk management policies please refer to Chart 1.

Chart 1: Risk Management Framework

Risk Management Framework

Principal Risks

	Credit Risk	Operational Risk	Funding and Liquidity Risk	Market Risk	Financial Crime Risk	Regulatory Risk	Model Risk	Conduct Risk
Policy documents	Credit risk policy	Enterprise Risk Management policy	Liquidity policy Treasury and large exposures policy	Treasury Instruments and Dealing Policy market Risk Policy	Anti-money laundering policy Sanctions policy	Compliance policy		Treating Customers Fairly policy
Risk Reporting	Credit Risk and Analytics reports	Operational Risk Reports	ALCO[1] and Treasury Reports	ALCO[1] and Treasury Reports	Anti-money laundering Steering Groups reports	Regulatory Risk reports	Model Valuation Team reports	Conduct and Voice of the Customer reporting
Monitoring Committee	Credit Risk Policy and Appetite Committee	Executive Risk Committee	Asset and Liability Committee	Asset and Liability Committee	Executive Risk Committee	Executive Risk Committee	Model Governance Committee	Executive Risk Committee
Oversight Committee	Risk Oversight Committee							

1. ALCO: Asset and Liability Committee

2.4 Risk appetite

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

Credit risk appetite

The credit risk appetite and policy is owned and approved by the Board annually. Portfolio level policies and credit risk appetite are recommended by the Executive to the Board via the Credit Risk, Policy and Appetite Committee ('CRPAC') and the ROC. The credit risk appetite is specified as a set of Key Performance Indicators ('KPIs'), concentration measures, and capital and impairment components. Policy and appetite are based on sound credit risk principles.

Market risk appetite

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

Funding and liquidity risk appetite

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

Conduct risk appetite

We have no appetite for conduct risk. We provide customers with simple, fairly priced products delivered with unparalleled levels of service and convenience and are committed to avoiding materially unfair outcomes of our customers.

Regulatory risk appetite

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

Financial crime risk appetite

The Risk team define our risk appetite and recommend this to the Board for approval. In order to monitor the effectiveness of our control framework and the alignment with our risk appetite, KPIs are defined, reported against and escalated through to the ROC.

Operational risk appetite

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

Model risk appetite

Model risk is increasingly complex across the Bank as increased scale and automation drive higher use and materiality of models than previously. Model risk appetite is defined for material models in the Bank wide risk appetite statement. This risk is managed across all models in use across the Bank, most significantly in assessing credit, stress testing, affordability, pricing, liquidity and interest rate risks amongst others.

2.5 Risk management framework

Our risk management framework is outlined in Chart 1 (see Section 2.3), setting out the relevant governance and control structure for each of our principal risks.

All key risks have been considered in detail as part of the capital adequacy assessment and are documented in the Internal Capital Adequacy Assessment Process ('ICAAP') document, which is approved by the Board. Liquidity risk is specifically considered in the annual Individual Liquidity Adequacy Assessment Process ('ILAAP') paper, which is also approved by the Board. Operational risk is managed through the Enterprise Risk Management Policy and Business Risk and Control Assessments.

We operate a three lines of defence model for risk management:

- The first line of defence is operational management, who manage risk by maintaining appropriate systems and controls that are operated and effective on a daily basis.
- The second line of defence comprises the risk management function, which provides governance and oversight in respect of all significant risk categories, such as credit risk, compliance and conduct risk, anti-money laundering, sanctions and counter-terrorist financing, operational risk, interest rate risk and liquidity risk.
- The third line of defence is Internal Audit, which provides independent assurance through internal and external audit reviews, each of which are reported to the Audit Committee.

2.5 Risk management framework

Our CRO who is responsible for ensuring each risk is identified, monitored and mitigated. Through the Risk function, the CRO is responsible for providing oversight of each of the key risks described above and independent assurance to the Board and the Directors that the principal risks are appropriately managed and that we are operating within our risk appetite.

Chart 2: Risk Management Function

Our risk management function is independent from the operational side of the Bank. It is responsible for ensuring that appropriate risk management processes and controls are in place, and that they are sufficiently robust.

The risk management function provides periodic independent reports on risk positions, risk management and performance against the risk appetite statements. Risk reports are provided to the CRPAC, the ERC, the ALCO, the ROC and the Board.

The reporting and oversight process is designed to ensure the committees which form the governance structure are aware of key risks and that there are adequate and effective controls in place for these risks.

Credit risk monitoring

Credit risk is overseen by the CRO, CRPAC and ROC. Three functions support the management of Credit Risk and report to the CRO :

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

Market risk monitoring

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

Funding and liquidity risk monitoring

Treasury Risk has responsibility for our compliance with liquidity policy and strategy. The Regulatory Reporting team monitors compliance with LCR. ALCO is the responsible committee for liquidity and funding risk. Funding and liquidity cannot be considered in isolation, and we have regard to liquidity risk, profitability, and capital optimisation when considering funding sources. We issued subordinated debt for the first time in 2018, primarily as a capital management measure.

Our liquidity mismatch chart is in Note 24 to the financial statements within our Annual Report and Accounts. Our liquidity position has remained stable over the year with our Liquidity Coverage Ratio ('LCR') remaining strong at 139% (2017: 141%).

Conduct risk monitoring

The simplicity of our offering drives a low level of reportable complaints, below the industry average. As well as monitoring the trends in the metrics outlined above we constantly analyse the root cause of complaints, as well as any underlying trends, to identify opportunities to improve service provision while delivering consistently fair outcomes for customers.

Regulatory risk monitoring

As an industry we are increasing regulatory obligations including MREL, IFRS 16, IFRS 9, PSD II, Open Banking and GDPR. The Board and Senior Management are focused on responding in a timely and effective way to these changes including ensuring we are appropriately resourced and have sufficient capability in these areas.

Financial crime risk monitoring

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

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

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

Each year we complete a financial crime risk assessment to validate that our financial crime control framework is commensurate and robust to manage our inherent business risk across each of the four areas.

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

Operational risk monitoring

We continuously develop and embed our approach to the management of operational risks with the aim of maintaining robust operational processes, systems and controls. In 2018 we enhanced our risk and control framework through the further development of our tools and processes for identifying, assessing, managing, monitoring and reporting operational risks. Key developments included: operational (including It) resilience; the deployment of new automated controls to mitigate the fraud risk experienced widely by the industry; operational disruption event response planning; and, enhanced operational risk scenario analysis, particularly as part of the our Internal capital Adequacy Assessment process ('ICAAP').

Model risk monitoring

A dedicated model monitoring team is responsible for assessing the ongoing performance of models against pre-specified tolerances approved by CRPAC as part of the model monitoring standards. Model monitoring is regularly performed and results are discussed at the MGC and CRPAC where actions are agreed and tracked for completion.

2.7 Risk hedging and mitigating

Credit risk mitigation

For our lending an essential means for mitigating credit risk is to secure suitable collateral. The principal collateral types acceptable for credit exposure to customers are:

- Residential and commercial property;
- Charges over business assets such as debentures, inventory and accounts receivable;
- Vehicles and other moveable assets;
- Cash and securities; and
- Guarantees received from third parties (individuals and companies).

For undrawn commitments we mitigate credit risk by regular customer monitoring to allow undrawn limits to be removed if we observe credit quality deterioration.

In respect of our investment securities we have a robust securities trading and investment policy which requires us to invest in high-quality liquid debt instruments. At the 31 December 2018 81% of our investment securities were rated as AAA (31 December 2017: 79%) with a further 15% (31 December 2017: 13%) rated AA- or higher with minimal use of derivatives for hedging purposes.

Market risk mitigation

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

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

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

Funding and liquidity risk mitigation

Our approach of having a long term loan-to-deposit ratio of 85-90% means we do not have reliance on wholesale funding to enable our ongoing lending.

Our deposits are diverse and are generally low cost and sticky in nature. This means they are less sensitive to competition within the deposit market, especially in a rising base rate environment.

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

Conduct risk mitigation

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

Our service-led business model and absence of legacy issues give us an inherent advantage. We are committed to doing the right thing for our customers and to making every wrong right.

Regulatory risk mitigation

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

Our Board, ROC and Executive Leadership Team (via the Executive Risk Committee) continues to monitor and oversees 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 policy and standards.

Financial crime risk mitigation

We invest in and refine our Financial Crime technology such as customer screening, payment profiling and customer authentication systems where we have evolved the effectiveness of these technology capabilities to reflect our risk appetite. We have also invested in enhancing our data analytics capabilities to further enhance our fraud prevention, detection and investigation controls.

We educate our customers with new fraud trends as well as hints and tips to enable them to protect themselves from becoming a victim of fraud.

We also continue to strengthen our dedicated Financial Crime specialist resource and equipping this resource and our colleagues across the Bank with specific training. We increased our headcount across both lines of defence and invested substantially in equipping a number of our colleagues with industry recognised Financial Crime qualifications. We rolled out further training and education to key colleagues in our stores.

We actively conduct horizon scanning activity to identify emerging trends and typologies as well as to identify and prepare for new legislation and regulation. As required, we will update our control framework to ensure alignment with these risks.

Operational risk mitigation

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

As we continue our growth journey, we do so safely through continued investment in our colleagues and training so that we can continue to support them in delivering consistently AMAZEING service to our customers, whilst maintaining a safe, reliable and resilient banking operation.

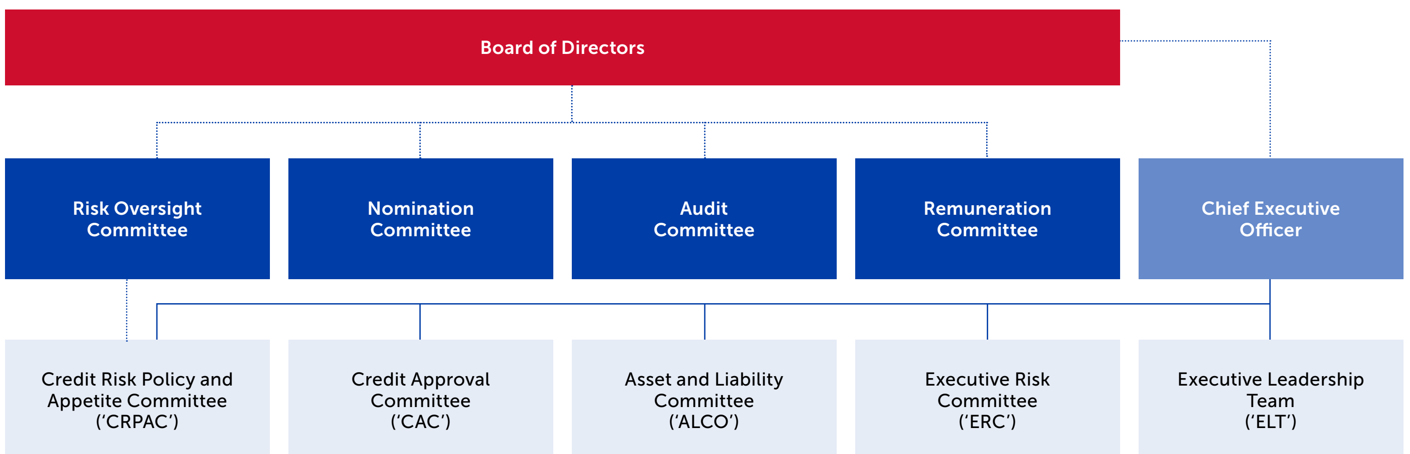
Model risk mitigation

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

2.8 Governance and committee structure

The responsibility for managing the principal risks ultimately rests with the Board of Directors. Chart 3 illustrates our key committees.

Chart 3: Governance Structure



This section outlines the details of the Board and principal committees which enable high-level oversight to be exercised in relation to our activities.

2.8.1 Board of Directors

Overview

The Board is the primary governing body and has ultimate responsibility for setting our strategy, corporate objectives and risk appetite. The strategy and risk appetite take into consideration the interests of stakeholders including depositors, customers and shareholders.

The Board specifically approves the level of risk which we are willing to accept to ensure there is an adequate framework in place for the reporting and management of those risks. The Board is responsible for maintaining a sufficient control environment to manage the principal risks, and is responsible for ensuring the capital and liquidity resources are adequate to achieve our objectives without taking undue risk.

The Board also maintains close oversight of current and future activities, through a combination of monthly board reports including financial results, operational reports, budgets and forecasts and periodic reviews of the main risks set out in the ICAAP and ILAAP documents.

Board Directors

The Board currently consists of the Non-Executive Chairman, two Executive Directors (the CEO and CFO) and nine Non-Executive Directors.

The Chairman is committed to ensuring that at least half of the Board (excluding the Chair) comprises independent Non-Executive Directors who objectively challenge management. While our balance of Independent Directors is currently slightly below the 50% minimum, this will be short lived as Keith Carby retires on 30 April 2019. Therefore from 1 May the Board, excluding the Chairman, will be made up of 10 Directors of which five (50%) are independent Non-Executive Directors, three are non-independent NEDs and two are Executive Directors.

The Directors' skills and experience span a wide range of sectors. Each Director brings a wealth of experience and skills to bear on all aspects of the management of the Company.

For the details of the Directors' biographies and skills, please refer to the Corporate Governance Overview section of our Annual Report and Accounts 2018.

During the year ended 31 December 2018, none of the Executive Directors held directorships in any other quoted company.

Diversity

Our inclusive approach promotes diversity and encourages our people to be their best at work, for our customers and for each other. Our colleagues represent the communities we serve and the locations where we're based. We know that our supportive culture is one of the reasons we attract, retain and develop our fantastic colleagues who create FANS.

Our inclusive culture is key to our model, and our Board Diversity Policy sets out our commitment to diversity and inclusion for the Board also. We know that a diverse Board, appointed on merit, with a broad range of skills, backgrounds, knowledge and experience, will be a more effective and responsible Board

For more details, please refer to Corporate Governance Overview section of our Annual Report and Accounts 2018 on our website, as well as our Board Diversity Policy available on our website at https://www.metrobankonline.co.uk/globalassets/documents/investor_documents/metro-bank-board-diversity-policy-2019.pdf

2.8.2 Board Committees

We have four Board Committees:

- the Audit Committee;
- the Risk Oversight Committee;
- the Nominations Committee; and
- the Remuneration Committee.

Audit Committee

The Audit Committee's key role is to review the integrity of our financial reporting and to oversee the effectiveness of the internal control systems and the work of the internal and external auditors. The Chair of the Committee meets with both Internal and External Audit privately on a regular basis throughout the year.

The four members of the Audit Committee are all independent Non-Executive Directors and bring a range of relevant business experience. At least one of the members of the Committee has recent and relevant financial experience and the Committee as a whole has competence in the banking sector. Regular attendees at the Audit Committee include the CEO, CFO, CRO, Director of Internal Audit, Group Finance Director, Financial Controller, Deputy Company Secretary and representatives from the external auditors, PriceWaterhouse Coopers LLP ('PwC').

The Committee:

- Monitors the integrity of the financial statements of the Bank, reviewing significant financial reporting issues and any judgements which they contain.
- Monitors and reviews the effectiveness of the Internal Audit function and approve the appointment or removal of the Head of Internal Audit.
- Oversees the relationship with the External Auditor including reviewing the engagement terms and fees, monitoring their independence and quality control as well as the audit findings, management letter and audited accounts.
- Review the adequacy and security of whistleblowing arrangements, as well as the policies for detecting fraud and preventing bribery.
- Monitor and review the adequacy and effectiveness of the Company's internal financial controls and risk management systems. Review and approve the statements in the Annual Report concerning internal controls and risk management.

Risk Oversight Committee

The Risk Oversight Committee assists the Board in providing leadership, direction, and oversight with regard to our risk governance and management, and also assists the Board in fostering a culture that emphasises and demonstrates the benefits of a risk-based approach to risk management and internal controls when creating FANS. It works closely with the Audit Committee.

It is chaired by an Independent Non-Executive Director and meets at least quarterly.

The Committee:

- Recommends our risk appetite to the Board;
- Reviews regularly our risk exposures in relation to the risk appetite;
- Reviews our risk policies, and approving or recommending to the Board for approval; and
- Monitors the effectiveness of our risk management processes and procedures put in place by Management.

Nominations Committee

The Committee is chaired by a Non-Executive Director, and comprises a further three Non-Executive Directors. The CEO has a standing guest invitation and the Chief People Officer also attends. The Nomination Committee meets not less than twice per year.

The Committee:

- Assists the Board in reviewing the structure, size and composition of the Board.
- Reviews succession plans for the Directors, including the Chairman and the CEO and other senior executives

Remuneration Committee

The Remuneration Committee's primary objective is to design a remuneration framework that promotes our growth and long-term success, while supporting our unique culture and model to deliver outstanding customer service.

The Committee is chaired by a Non-Executive Director, and comprises a further two Non-Executive Directors. The CEO has a standing guest invitation and the Chief People Officer also attends. The Remuneration Committee meets not less than twice per year.

The Committee:

- Determines the overall remuneration policy for all colleagues, and in particular the policy and the level of remuneration of Code staff which includes Executive Directors.
- Provides an oversight of best practice in the external market place.

2.8.3 Chief Executive Management Committees

The Chief Executive, supported by the Executive Management Team, is responsible for executing our strategy and making decisions and recommendations to the Board, as appropriate, via the following risk committees:

Table 2: Chief Executive Management Committees

Committees	Responsibilities
Asset and Liability Committee ('ALCO')	The Committee is chaired by the CFO, meets monthly and is responsible for: ensuring that an appropriate balance is maintained between funding and lending activities; ensuring that we meet internal liquidity targets as set out in the Liquidity Policy; analysis of Capital Market trends, considered along with actual and projected business performance to assess the adequacy of funding to meet the projected targets; agreement of pricing decisions to ensure visibility of trading and capital impact; and monitoring interest rate risk.
Executive Risk Committee ('ERC')	The Committee is chaired by the CRO, meets monthly and is responsible for: reviewing enterprise, regulatory and compliance risk management issues with regard to our risk appetite; oversight of our Enterprise Risk Management framework; oversight of the performance of the KRIs; reviewing Assurance reports and findings; and, making recommendations for adjustment of policies to the Board.
Credit Approval Committee ('CAC')	The Committee is an executive committee reporting to the ROC. It is chaired by the CRO or Director of Commercial Credit and is responsible for: sanctioning of higher value lending requests, and any exceptions to policy; monitoring the Bank's overdue accounts; and granting and reviewing delegated lending authorities.
Credit Risk Policy and Appetite Committee ('CRPAC')	The Committee is chaired by the CRO, meets monthly and is responsible for: oversight of our credit risk policies; reviewing proposals on risk appetite; monitoring portfolio performance against risk appetite; along with the CFO, approving the impairment levels; and, approving all material aspects of IRB rating systems, including all material models.

2.8.4 Executive Management Committees

There are a further six sub-committees which meet separately, as follows:

Table 3: Executive Sub-Committees

Sub-committees	Responsibilities
Finance Committee	The Committee is responsible for reviewing risks and opportunities and assessing performance across actual and forecast of: • Cost • Income • Capital • Provisions
Trading Committee	The Committee is responsible for reviewing trading performance across : • Regional Banking • Contact Centres • Private Banking • Operations and IT • Commercial Banking • Digital Channels • Partnerships

Sub-committees	Responsibilities
Voice of the Customer Committee	The Committee is responsible for providing direction on actions required to ensure we deliver amazing customer service and consistently fair customer outcomes. It reviews performance against key customer metrics: • Magic Shop reviews • Expressions of Dissatisfaction • Customer Satisfaction Guarantees • Net Promoter Scores • MI and Reporting of EoD root cause analysis, and actions taken
Voice of the Colleague (Culture) Committee	The Committee is responsible for embedding and strengthening our unique culture, through people interventions, and for reviewing the performance of key colleague metrics. Specific areas include: • "Voice of the Colleague" metrics (colleague engagement scores) • Training and development strategies • Succession planning and talent interventions • Colleague communications • AMAZEING Review ratings and performance calibration • Our approach to total reward • Insight from key HR Data and the actions needed
Audit Management Committee	The Committee is responsible for: • Providing an update to the executives on activities of internal audit (progress against audit plan) • Updating outstanding audit findings, including any requests from external stakeholders
Change & IT Committee	The Committee is responsible for: • Change ELT, Chaired by the CIO. This body ensures the combination of the Pillars deliver the change activities to Time, Cost, and Quality thus enabling agreed benefits are achieved as per the Business Cases. It is the escalation point for all Financial and Delivery Risk • The IT ELT chaired by the CIO. This body is responsible for reviewing performance across IT run, maintain and build. It is also an escalation point for IT & Cyber risk. IT ELT Also provides executive oversight across the IT Resilience programme

3. Capital Resources

As at 31 December 2018, our capital base was made up of £1,171 million of Tier 1 capital and £249 million of Tier 2 capital. Tier 1 capital consisted 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 consisted of Fixed Rate Reset Callable Subordinated Notes due 2028. The details of the main features of these instruments can be found in Table 5 of Section 3.1.

3.1 Capital composition

Table 4 summarises the composition of regulatory capital. Our capital adequacy was in excess of the minimum required by the regulators at all times.

Table 4: Capital Composition

		31 December 2018 £'million	31 December 2017 £'million
	CET1 capital: Instruments and reserves		
1	Capital instruments and the related share premium accounts	**1,605**	1,304
	Of which: ordinary shares		
2	Retained earnings	**(209)**	(219)
3	Accumulated other comprehensive income (and other reserves)	**7**	12
6	**CET1 capital before regulatory adjustments**	**1,403**	1,097
	CET1 capital: regulatory adjustments		
7	Additional value adjustments (negative amount)		
8	Intangible assets (net of related liability)	**(197)**	(148)
10	Deferred tax assets that rely on future profitability excluding those arising from temporary differences	**(47)**	(51)
	Other regulatory adjustments (IFRS 9)	**12**	-
28	**Total regulatory adjustments to CET1**	**(232)**	(199)
29	**CET1 capital**	**1,171**	897
45	**Tier 1 capital**	**1,171**	897
	Tier 2 capital: Instruments and provisions		
46	Capital instruments and the related share premium accounts	**249**	-
51	**Tier 2 capital before regulatory adjustments**	**249**	-
58	**Tier 2 capital**	**249**	-
59	**Total capital**	**1,420**	897
60	**Total risk weighted assets**	**8,936**	5,882
	Capital rations and buffers		
61	CET1	**13.1%**	15.3%
62	Tier 1	**13.1%**	15.3%
63	Total capital	**15.9%**	15.3%
64	Institution specific buffer requirement	**7.36%**	5.75%
65	*Of which: capital conservation buffer requirement*	**1.88%**	1.25%
66	*Of which: countercyclical buffer requirement*	**0.98%**	0%
67	*Of which: systemic risk buffer requirement*	**0%**	0%
67a	*Of which: GSII or OSII buffer*	**0%**	0%

Features of the capital instruments

We issued £250 million fixed rate reset callable subordinated notes in June 2018, which qualify as Tier 2 capital, and raised £303 million of CET1 capital in July 2018. Further details of each of these raises can be found in the Financial Review section of our 2018 Annual Report and Accounts.

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

Table 5: Capital instruments main features

	Capital Instruments main features		
1	Issuer	Metro Bank PLC	Metro Bank PLC
2	Unique identifier	GB00BZ6STL67	XS1844097987
3	Governing law(s) of the instrument	English	English
	Regulatory treatment		
4	Transitional CRR rules	Common Equity Tier 1	Tier 2
5	Post-transitional CRR rules	Common Equity Tier 1	Tier 2
6	Eligible at solo/(sub-)consolidated/solo and (sub-)consolidated	Consolidated	Consolidated
7	Instrument type (types to be specified by each jurisdiction)	Ordinary Shares	Fixed Rate Reset Callable Subordinated Notes
8	Amount recognised in regulatory capital (£)	97.42	248,812,045
9	Nominal amount of instrument (£)	97.42	250,000,000
9a	Issue price	0.0001p	Par value
9b	Redemption price	n/a	100%
10	Accounting classification	Equity	Liability
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	Noncumulative 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
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

	Capital Instruments main features		
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

3.2 Reconciliation of statutory equity to regulatory capital

Table 6: Reconciliation of statutory equity to regulatory capital

	31 December 2018 £'million	31 December 2017 £'million
Statutory total equity	1,403	1,097
Less pension regulatory adjustments	–	–
Less additional value adjustments	12	–
Less intangible assets	(197)	(142)
Less deferred tax assets relying on future profitability	(47)	(58)
Less cash flow hedge	–	–
Additional Tier 1 foreseeable dividend	–	–
Regulatory Tier 1 capital	1,171	897

3.3 Leverage ratio

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

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

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

We actively monitored and manage excessive leverage:

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

Our leverage ratio at 31 December 2018 was 5.4% (31 December 2017: 5.5%) and was above the regulatory minimum of 3% at all times during 2018. Tables 7 and 8 provide more details on the components of the exposure measure used to calculate our leverage ratio, disclosed in accordance with the templates prescribed by the EBA.

The movement in the leverage ratio in the year was caused by an increase in the total leverage exposure and the Tier 1 capital raise.

PILLAR 3 CONTINUED

Table 7: LRSum: Summary reconciliation of accounting assets and leverage ratio exposures

		31 December 2018 £'million	31 December 2017 £'million
1	**Total assets as per published financial statements**	**21,647**	16,355
4	Adjustments for derivative financial instruments	**–**	–
5	Adjustments for securities financing transactions (SFTs[1])	**–**	–
6	Adjustments for off-balance sheet items	**267**	181
7	Other adjustments	**(210)**	(86)
8	**Total leverage ratio exposure**	**21,704**	16,450

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

Table 8: LRCom: Leverage ratio common

		31 December 2018 £'million	31 December 2017 £'million
	On-balance sheet exposures (excluding derivative and SFTs)		
1	On-balance sheet items (excluding derivatives, SFTs and fiduciary assets, but including collateral)	**21,686**	16,468
2	(Asset amounts deducted in determining Tier 1 capital)	**(249)**	(199)
3	Total on-balance sheet exposures (excluding derivatives, SFTs and fiduciary assets)	**21,437**	16,269
	Other off-balance sheet exposures		
17	Off-balance sheet exposures at gross notional amount	**1,125**	887
18	(Adjustments for conversion to credit equivalent amounts)	**(858)**	(706)
19	Other off-balance sheet exposures	**–**	–
	Capital and total exposures		
20	Tier 1 capital	**1,171**	897
21	Total leverage ratio exposures	**21,704**	16,450
	Leverage ratio		
22	Leverage ratio	**5.4%**	5.5%

3.4 Application of transitional arrangements for IFRS 9

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

Table 9: 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 2018 £'million	31 December 2017 £'million
	Available capital (amounts)		
1	CET1 capital	**1,171**	918
2	CET1 capital as if IFRS 9 or analogous ECLs transitional arrangements had not been applied	**1,159**	897
3	Tier 1 capital	**1,171**	918
4	Tier 1 capital as if IFRS 9 or analogous ECLs transitional arrangements had not been applied	**1,159**	897
5	Total capital	**1,420**	918
6	Total capital as if IFRS 9 or analogous ECLs transitional arrangements had not been applied	**1,408**	897
	Risk-weighted assets (amounts)		
7	Total risk-weighted assets	**8,936**	5,861
8	Total risk-weighted assets as if IFRS 9 or analogous ECLs transitional arrangements had not been applied	**8,924**	5,882
	Capital ratios		
9	CET1 (as a percentage of risk exposure amount)	**13.1%**	15.7%
10	CET1 (as a percentage of risk exposure amount) as if IFRS 9 or analogous ECLs transitional arrangements had not been applied	**13.0%**	15.3%
11	Tier 1 (as a percentage of risk exposure amount)	**13.1%**	15.7%
12	Tier 1 (as a percentage of risk exposure amount) as if IFRS 9 or analogous ECLs transitional arrangements had not been applied	**13.0%**	15.3%
13	Total capital (as a percentage of risk exposure amount)	**15.9%**	15.7%
14	Total capital (as a percentage of risk exposure amount) as if IFRS 9 or analogous ECLs transitional arrangements had not been applied	**15.8%**	15.3%
	Leverage ratio		
15	Leverage ratio total exposure measure	**21,704**	16,450
16	Leverage ratio	**5.4%**	5.5%
17	Leverage ratio as if IFRS 9 or analogous ECLs transitional arrangements had not been applied	**5.3%**	5.4%

4. Capital Requirements

4.1 Minimum capital requirements

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

Table 10 sets out our RWAs and Pillar 1 capital requirements. We have applied the Standardised Approach to measure credit risk RWAs and the BIA to measure operational risk RWAs. Under the approach we calculate our Pillar 1 capital requirement based on 8% of total RWAs. This covers credit risk, operational risk, market risk and counterparty credit risk. Our capital adequacy was in excess of the minimum required by the regulators at all times.

The year-on-year increase in RWAs was primarily driven by an increase in credit risk RWAs due to increases in loan exposures, and the £900 million adjustment to RWAs (see Section 12.1 Regulatory Risk). Operational risk RWAs increased due to revenue growth.

Table 10: EU OV1 – Overview of risk weighted assets

		RWAs		Minimum capital requirements
		31 December 2018 £'million	31 December 2017 £'million	31 December 2018 £'million
1	Credit risk (excluding counterparty credit risk (CCR))	8,560	5,646	685
2	*Of which the standardised approach*	8,560	5,646	685
6	CRR	2		–
7	*Of which mark to market*	2	–	–
12	*Of which CVA*	–	–	–
19	*Market Risk*	4	2	–
20	*Of which the standardised approach*	4	2	–
23	Operational risk	370	234	30
24	*Of which basic indicator approach*	370	234	30
27	Amounts below the thresholds for deduction (subject to 250% risk weight)	–	–	–
29	Total	8,936	5,882	715

Table 11: Capital requirements

	31 December 2018	
Minimum requirements	CET1	Total capital
Pillar 1	4.50%	8.00%
Pillar 2A	0.85%	1.52%
Total capital requirement (TCR)[1]	5.35%	9.52%
Capital conservation buffer	1.875%	1.875%
UK countercyclical capital buffer	0.98%	0.98%
Total (excluding PRA buffer)	8.205%	12.375%

1. We used TCR for the year ended 31 December 2018

4.2 Pillar 1

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

4.3 Pillar 2A

4.3.1 Capital requirements

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

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

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

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

4.3.2 ICAAP

As part of the Pillar 2A approach to capital adequacy, the Board is required to consider all material risks which we face and to determine whether additional capital is required in order to provide additional protection to depositors and borrowers and to ensure we are sufficiently capitalised to withstand a severe economic downturn. These assessments are documented in our ICAAP and reviewed by the PRA as part of the SREP. The PRA then sets the capital planning buffer that we should hold, but which is available for use should adverse circumstances materialise that are outside its normal and direct control.

The purpose of the ICAAP is to set out how we identify and manages the key risks to which we are exposed and to detail our capital requirements, capital resources and capital adequacy over the planning period.

The key assumptions and risk drivers used to create the ICAAP are regularly monitored and reported, and any material deviation from our forecast and risk profile will mean the ICAAP will need to be updated. The principal risks which are considered as part of the ICAAP are detailed in Section 2.

4.3.3 Capital buffers

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

Capital conservation buffer ('CCB')

The CCB is designed to ensure that institutions build up capital buffers outside of times of stress that can be drawn upon if required. As at 31 December 2018, the capital conservation buffer was 1.88%. The level will reach a final requirement of 2.5% of RWAs in 2019.

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 (FPC) is responsible for setting the UK CCyB rate for credit exposures located in the UK. As at 31 December 2018 the UK CCyB was set to 1%. The 0.98% shown in Table 11 is the weighted average of CCyB's issued by various national bodies and exposures in those countries.

The geographical distribution of our credit exposures relevant for the calculation of its countercyclical capital buffer is disclosed in Table 12.

Table 12: Countercyclical Capital Buffer

	31 December 2018						
	General credit exposures	Securitisation exposure	Own funds requirements				
	Exposure value for SA £'million	Exposure value for SA £'million	Of which: General credit exposures £'million	Of which: Securitisation exposures £'million	Total £'million	Own funds requirement weights	Countercyclical capital buffer rate %
	010	050	070	090	100	110	120
UK	15,642	2,876	1,251	230	1,481	0.982	1%
North America	43	161	3	13	16	0.011	0%
Other European Countries	25	24	2	2	4	0.003	0–1.25%
Rest of the World	93	–	7	–	7	0.005	0–2%
Total	15,803	3,061	1,264	245	1,509	1.00	

Table 13: Amount of institution-specific countercyclical capital buffer

		31 December 2018 £'million
010	*Total risk exposure amount*	8,936
020	Institution specific countercyclical buffer rate	0.98%
030	**Institution specific countercyclical buffer requirement**	87.57

G-SII buffer

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

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

5. Credit Risk

Credit risk is the risk of principal loss in the event of defaulting mortgage and loan contracts. Credit risk arises primarily from our loan book but can also arise from other on and off balance sheet activities.

Credit risks associated with lending are managed through the use of detailed lending policies which outline our approach to lending, underwriting criteria, credit mandates, concentration limits and product terms. We maintain a dynamic approach to credit risk management, and will take necessary steps if the credit performance deteriorates due to economic or sector-specific weaknesses. This approach to deteriorating credit performance is specifically undertaken by the Business and Credit Support team.

The Director of Credit Risk and Analytics is responsible for development and oversight of the lending policies and for ongoing monitoring and analysis of portfolio performance within policy and, therefore, against risk appetite thresholds (including concentration limits). The Credit Risk and Analytics team also performs periodic stress tests, using a range of macro and micro economic data to assess the resilience of the lending portfolios to a range of external shocks.

The Director of Commercial Credit has responsibility for commercial underwriting and lending reviews for the key aspects of the lending portfolio. The Director also provides mentoring and business support, covenant monitoring, credit committee management, case credit grading and credit training delivery. We also seek to mitigate credit risk by focusing on business sectors where we have specific expertise and limiting exposures on larger loans, certain sectors and other factors which can represent higher risk. We also seek to obtain security cover and where appropriate personal guarantees from borrowers.

The Business and Credit Support team provide work-out and close monitoring for exposures where there is a risk payment will not be achieved in full and in line with the conditions of the loan.

Each business area has its own lending policy and a dedicated team which assesses credit risk, supported by a Head of Credit having oversight of lending activities.

The Risk team, CAC, CRPAC and ROC have oversight responsibility for credit risk; and credit assurance reviews are conducted by Internal Audit, the outputs of which are reported to the Audit Committee.

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 in Table 14. 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 2018 had increased by £5,254 million, primarily due to increases on lending secured on immovable property (£4,477 million) in line with our overall lending growth and increases in cash held with the Bank of England.

The increase in RWAs is mainly due to the growth in lending, which has been mainly driven by growth in retail mortgages and loans to businesses secured by property. Of the overall £2,914 million increase in credit risk RWAs, £900 million was due to the adjustment made to change the risk weighting applied to commercial loans secured against property and PBTL assets, where portfolios are larger or more complex.

Table 14: Credit risk exposures by exposure class

	31 December 2018		
Exposures subject to the Standardised Approach	Exposure value £'million	RWA £'million	Capital required £'million
Central governments or central banks	2,652	–	–
Institutions	188	38	3
Corporates	633	574	46
Retail	859	565	45
Secured by mortgages on immovable property	12,938	5,938	476
Covered bonds	507	51	4
Claims on institutions and corporates with a short-term credit assessment	134	66	5
Securitisation Position	3,061	595	48
Exposure at default	59	65	5
Items associated with particularly high risk	51	77	6
Other Exposures	622	591	47
Total	21,704	8,560	685

	31 December 2017		
Exposures subject to the Standardised Approach	Exposure value £'million	RWA £'million	Capital required £'million
Central governments or central banks	2,375	–	–
Institutions	112	22	2
Corporates	602	548	44
Retail	742	485	39
Secured by mortgages on immovable property	8,489	3,280	262
Covered bonds	317	32	3
Claims on institutions and corporates with a short-term credit assessment	249	120	10
Securitisation Position	3,025	626	50
Exposure at default	53	58	5
Items associated with particularly high risk	24	36	3
Other Exposures	462	439	35
Total	16,450	5,646	453

5.1.2 Geographic distribution of credit risk exposures

Our credit risk exposures as at 31 December 2018 and 31 December 2017 by geography are detailed in Table 15.

Table 15: Credit risk exposures by geography

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

	31 December 2017				
Standardised Credit Risk	UK £'million	North America £'million	Other European countries £'million	Rest of the world £'million	Total £'million
Central governments or central banks	2,316	59	–	–	2,375
Institutions	112	–	–	–	112
Corporates	577	–	–	25	602
Retail	741	–	–	1	742
Secured by mortgages on immovable property	8,434	–	5	49	8,488
Covered bonds	317	–	–	–	317
Claims on institutions and corporates with a short-term credit assessment	120	47	6	76	249
Securitisation position	3,006	19	–	–	3,025
Exposure at default	54	–	–	–	54
Items associated with particularly high risk	24	–	–	–	24
Other exposures	462	–	–	–	462
Total	**16,163**	**125**	**11**	**151**	**16,450**

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

5.1.3 Residual Contractual maturity of Credit Risk exposures

Our exposures as at 31 December 2018 and 31 December 2017 analysed by remaining contractual maturity are detailed in Table 16.

Table 16: Credit risk exposures by residual contractual maturity

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

	31 December 2017					
Standardised Credit Risk	On demand £'million	Up to 12 months £'million	1-5 years £'million	5-10 years £'million	More than 10 years £'million	Total £'million
Central governments or central banks	2,070	54	251	–	–	2,375
Institutions	111	1	–	–	–	112
Corporates	153	175	76	123	75	602
Retail	315	105	49	103	170	742
Secured by mortgages on immovable property	–	167	545	1,339	6,438	8,489
Covered bonds	–	108	209	–	–	317
Claims on institutions and corporates with a short-term credit assessment	–	69	180	–	–	249
Securitisation position	–	287	2,247	491	–	3,025
Exposure at default	–	11	42	–	–	53
Items associated with particularly high risk	–	11	10	1	2	24
Other exposures	41	421	–	–	–	462
Total	2,690	1,409	3,609	2,057	6,685	16,450

5.1.4 Industry distribution of Credit Risk exposures

Our exposures at 31 December 2018 and 31 December 2017 analysed by industry are detailed in Table 17.

Table 17: Credit risk exposures by industry

	31 December 2018						
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	–	–	–	–	–	–	–
Institutions	–	–	–	–	–	188	–
Corporates	33	1	46	37	25	36	4
Retail	6	1	36	8	–	96	2
Secured by mortgages on immovable property	99	14	156	203	–	60	124
Covered bonds	–	–	–	–	–	–	–
Claims on institutions and corporates with a short-term credit assessment	–	–	6	–	–	5	–
Securitisation position	–	–	–	–	3,061	–	–
Exposure at default	–	–	1	1	–	–	–
Items associated with particularly high risk	10	–	6	4	–	–	5
Other exposures	–	–	–	–	–	–	–
Total	148	16	251	253	3,086	385	135

	31 December 2018							
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	–	–	–	–	60	2,592	–	2,652
Institutions	–	–	–	–	–	–	–	188
Corporates	78	8	28	–	97	1	239	633
Retail	193	3	8	488	8	–	10	859
Secured by mortgages on immovable property	2,544	13	89	9,446	60	45	85	12,938
Covered bonds	–	–	–	–	507	–	–	507
Claims on institutions and corporates with a short-term credit assessment	–	–	–	–	79	–	44	134
Securitisation position	–	–	–	–	–	–	–	3,061
Exposure at default	3	1	3	50	–	–	–	59
Items associated with particularly high risk	26	–	–	–	–	–	–	51
Other exposures	–	–	–	–	–	–	622	622
Total	2,844	25	128	9,984	811	2,638	1,000	21,704

Standardised Credit Risk	31 December 2017 Construction £'million	Education £'million	Health & Social Work £'million	Hospitality £'million	Investment & Unit Trusts £'million	Legal, Accountancy & Consultancy £'million	Real estate (Management of) £'million
Central governments or central banks	–	–	–	–	–	–	–
Institutions	–	–	–	–	–	112	–
Corporates	15	–	38	28	15	42	3
Retail	4	–	33	9	1	98	2
Secured by mortgages on immovable property	68	5	152	159	25	53	106
Covered bonds	–	–	–	–	–	–	–
Claims on institutions and corporates with a short-term credit assessment	–	–	5	–	–	5	–
Securitisation position	–	–	–	–	3,025	–	–
Exposure at default	–	–	1	1	–	5	–
Items associated with particularly high risk	8	–	–	4	–	–	3
Other exposures	–	–	–	–	–	–	–
Total	95	5	229	201	3,066	315	114

Standardised Credit Risk	31 December 2017 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	–	–	–	–	59	2,316	–	2,375
Institutions	–	–	–	–	–	–	–	112
Corporates	79	10	15	–	106	–	251	602
Retail	206	4	6	364	6	–	9	742
Secured by mortgages on immovable property	1,635	9	73	6,092	33	10	69	8,489
Covered bonds	–	–	–	–	317	–	–	317
Claims on institutions and corporates with a short-term credit assessment	–	–	–	–	121	–	118	249
Securitisation position	–	–	–	–	–	–	–	3,025
Exposure at default	4	1	–	41	–	–	–	53
Items associated with particularly high risk	9	–	–	–	–	–	–	24
Other exposures	–	–	–	–	–	–	462	462
Total	1,933	24	94	6,497	642	2,326	909	16,450

5.2 Credit risk – lending

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

5.2.1 Residential Mortgages

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

We have a conservative approach to lending: we will typically only lend up to up to 90% debt-to-value ('DTV'). The average DTV of the residential mortgage loan book is 61% (31 December 2017: 60%). We perform indexed revaluation of the collateral at least on an annual basis.

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

5.2.2 Commercial Mortgages

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

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

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

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

5.2.3 Non-performing Loans and Provisioning

Definitions

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

Impaired: A 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. Details of Impaired Loans can be found in our Impairment Policy and Methodology.

Management

The performance of loan assets is monitored monthly. Late payments and arrears cases are reported in detail and reviewed on a regular basis, detailed credit reports are submitted for review to the monthly CRPAC 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.

IFRS 9

In 2017 we developed and implemented IFRS 9 compliant models that allows the calculation of Expected Credit Losses ('ECL'). We assess on a forward-looking basis the ECL associated with the assets carried at amortised cost and fair value through other comprehensive income ('FVOCI') and recognise a loss allowance for such losses at each reporting date.

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

IFRS 9 requires a higher level of expected credit loss to be recognised for underperforming loans. This is considered based on a staging approach presented in Table 18.

Table 18: Staging approach under IFRS 9

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

For details on IFRS 9, please refer to Note 23 of our 2018 Annual Return and Accounts.

At the end of 2018 we held an ECL provision of £34 million (2017: we held a collective impairment provision of £14 million under IAS 39).

Table 19: Loss allowance under IFRS 9

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

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

		Gross carrying amount value defaulted exposures	
		a	a
		2018 £'million	2017 £'million
1	As at 1 January	55*	21
2	Loans and debt securities that have defaulted or impaired since the last reporting period	35	20
3	Returned to non-defaulted status	(9)	–
4	Amounts written off	(1)	(1)
5	Other changes	(22)	–
9	**As at 31 December**	58	40

* The 2018 opening balance has been adjusted due to the introduction of IFRS 9.

Table 21: Impaired exposures and past due exposures by industry

	31 December 2018 Past due but not impaired £'million	Impaired £'million
Personal	67	48
Hospitality	39	1
Develop, Buy, Sell and Rent Real Estate	38	5
Health and Social Work	11	1
Construction	4	–
Legal, Accounting, Consultancy	3	–
Other	11	7
Total	173	62

Analysis by geography

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

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

5.2.4 Credit Risk Mitigation (CRM)

CRR article 453 requires disclosure for the use of CRM, e.g. cash and certain securities held as collateral. Whilst these types of collateral are used in the lending decision process, they are not used when calculating regulatory exposure value.

5.3 Credit risk – liquidity portfolio and investment

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

We use Standard and Poor's (S&P), Moody's and Fitch as External Credit Assessment Institutions ('ECAIs'). Ratings from these agencies are mapped to credit quality steps as per CRD IV rules, in order to assess the risk weight for standardised credit risk calculations. Table 22 provides the credit ratings and prescribed risk weights associated with credit quality steps under Standardised Approach.

Table 22: Long term mapping of ECAIs' credit assessment to credit quality steps

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

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

Table 23: Exposure by credit quality step

	31 December 2018 £'million	31 December 2017 £'million
Central governments and central banks		
Credit quality step 1	551	323
Credit quality step 2	–	–
Credit quality step 3	–	–
Credit quality step 4	–	–
Credit quality step 5	–	–
Credit quality step unrated	–	–
Total	551	323

	31 December 2018 £'million	31 December 2017 £'million
Institutions		
Credit quality step 1	30	31
Credit quality step 2	–	11
Credit quality step 3	42	43
Credit quality step 4	–	–
Credit quality step 5	–	–
Credit quality step unrated	–	–
Total	72	85
Corporates		
Credit quality step 1	–	–
Credit quality step 2	27	52
Credit quality step 3	53	125
Credit quality step 4	–	–
Credit quality step 5	–	–
Credit quality step unrated	–	–
Total	80	177
Covered bonds		
Credit quality step 1	504	313
Credit quality step 2	–	–
Credit quality step 3	–	–
Credit quality step 4	–	–
Credit quality step 5	–	–
Credit quality step unrated	–	–
Total	504	313
Securitisation		
Credit quality step 1	2,828	2,910
Credit quality step 2	86	68
Credit quality step 3	–	–
Credit quality step 4	–	–
Credit quality step 5	–	–
Credit quality step unrated	–	–
Total	2,914	2,978

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

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 seeks to minimise operational failures. Key Risk Indicators are used to provide an overview of the control environment and to assess performance against our operational risk appetite. As part of the ICAAP our key operational risks are assessed, stressed and quantified.

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

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

Table 24: Operational risk RWAs

	2018 £'million
As at 1 January	234
Movement	136
As at 31 December	370

7. Counterparty Credit Risk

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

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

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

The calculated exposures are risk weighted under the Standardised Approach for credit risk. Minimum capital requirements are disclosed within our disclosures for credit risk (2018: £153,000, 2017: £26,000).

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

Table 25: CRR 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 2018	6,643	2,934	9,577	1,915	153
31 December 2017	295	1,309	1,604	321	26

Table 26: Credit Valuation Adjustment

Credit Valuation Adjustment	Total Exposure Value £000's	RWA £000's	Capital Requirement £000's
31 December 2018	9,577	452	36
31 December 2017	1,604	188	15

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

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

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

8. Liquidity Risk
8.1 Liquidity risk management
Liquidity risk is the risk that we will encounter difficulty in meeting obligations associated with our financial liabilities that are settled by delivering cash or another financial asset, or will incur a disproportionate cost in meeting these obligations. Our liquidity position has remained stable over the year with the LCR remaining strong at 139% (2017: 141%) and we hold excess liquidity above regulatory minimum requirements.

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

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

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

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

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

Monitoring

Treasury Risk has responsibility for our compliance with liquidity policy and strategy. The Regulatory Reporting team monitors compliance with LCR. ALCO is the responsible committee for liquidity and funding risk. Funding and liquidity cannot be considered in isolation and we have regard to liquidity risk, profitability and capital optimisation when considering funding sources. We issued subordinated debt for the first time in 2018, primarily as a capital management measure.

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

Contingency Funding Plan

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

Risk Appetite

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

8.2 Liquidity coverage ratio

Table 27 provides a summary of our LCR. Our LCR as at 31 December 2018 was 139.2% which comfortably exceeds the Basel Committee's minimum requirement of 100% for the time period. LCR has remained relatively stable year on year.

Table 27: EU LIQ1 – Liquidity coverage ratio

	31 December 2018 £'million	31 December 2017 £'million
Total HQLA	**3,489**	2,851
Total net cash outflow	**2,506**	2,022
Liquidity coverage ratio (LCR)	**139.2%**	141.0%

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, collaterise or credit enhance any transaction from which it cannot be freely withdrawn.

Our encumbered assets are used to support collateral requirements for central bank operations, third party repurchase agreements, securitisation and the Term Funding Scheme.

Tables 28 and 29 provide breakdown of the encumbered and unencumbered assets. The tables are prepared using the Pillar 3 asset encumbrance disclosure Template A and Template C, in accordance with PRA and EBA regulatory reporting requirements. Template B is not applicable as we do not have any received collateral.

As at 31 December 2018 we have £5,768 million (31 December 2017: £4,200 million) of encumbered assets and £15,881 million (31 December 2017: £12,182 million) of unencumbered assets.

Table 28: Encumbered and unencumbered assets (Template A)

		31 December 2018			
		Carrying amount[1] of unencumbered assets £'million	Fair value of encumbered assets £'million	Carrying amount[1] of unencumbered assets £'million	Fair value of unencumbered assets £'million
		010	040	060	090
010	Assets of the reporting institutions	5,768	n/a	15,881	n/a
030	Equity instruments	–	n/a	–	n/a
040	Debt securities	1,767	1,757	2,365	2,345
050	*Of which: covered bonds*	–	–	507	506
070	*Of which: issued by general governments*	300	300	191	190
080	*Of which: issued by financial corporations*	1,420	1,409	1,931	1,913
120	Other assets	–	n/a	856	n/a

		31 December 2017			
		Carrying amount[1] of unencumbered assets £'million	Fair value of encumbered assets £'million	Carrying amount[1] of unencumbered assets £'million	Fair value of unencumbered assets £'million
		010	040	060	090
010	Assets of the reporting institutions	4,200	n/a	12,182	n/a
030	Equity instruments	–	n/a	–	n/a
040	Debt securities	2,423	2,443	1,601	1,611
050	*Of which: covered bonds*	–	–	317	319
070	*Of which: issued by general governments*	128	129	177	177
080	*Of which: issued by financial corporations*	1,982	2,000	1,077	1,083
120	Other assets	–	n/a	629	n/a

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

Table 29: Sources of encumbrance (Template C)

		31 December 2018		31 December 2017	
		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
		010	040	060	090
010	Carrying amount of selected financial liabilities	4,145	5,768	3,442	4,200

10. Securitisation

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

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

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

Table 30: Exposure value of purchased securitisation

	Exposure value	
	31 December 2018 £'million	31 December 2017 £'million
Residential Mortgage Backed Securities	**3,061**	3,025

11. Market Risk

Market risk is the risk that changes in market prices, such as interest rates or prices of investment securities, will affect our income or the value of our holdings of financial instruments. Our 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. Our earnings and economic value arise primarily from its core lending and savings activities, with minimal impact from market risk position taking. All our activity we undertake is considered banking book activity. The objective of our market risk management strategy is to manage and control market risk exposures within acceptable parameters.

Risk Framework

The ROC has overall responsibility for establishing and maintaining an adequate market risk management framework, including risk appetites that enable the management of market risk in the banking book. Our Market Risk Policy is set with a view to ensuring that our funding resources are invested in assets that satisfy our earnings risk and economic value risk appetites. We are in the business of accepting deposits which involves maintaining a portfolio of liquid assets: we therefore have appetite for the revaluation risk that corresponds to holding a portfolio of liquid assets that can be sold at short notice to finance our activities and manage liquidity. We have very limited exposure to foreign exchange risk. Foreign exchange assets and liabilities are matched off closely in each of the currencies in which we operate, and less than 5% of our assets and liabilities are in currencies other than pounds.

Mitigation

We benefit from natural offsetting between certain assets and liabilities, which may be based on both contractual and behavioural characteristics of these positions. Where natural hedging is insufficient, Treasury hedges 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. We have hedge accounting solutions in place to reduce the accounting P&L volatility arising from these hedging activities. The Treasury and Treasury Risk teams work closely together and 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.

Measurement

We monitor interest rate risk exposure using:

- Economic value sensitivity: calculating repricing mismatches across our assets and liabilities and then evaluating the change in value arising from a change in the yield curve. Our risk appetite scenario is based on a parallel rate movement of 2% to all interest rates, but we evaluate based on a series of other parallel and non-parallel rate changes. The scenarios are designed to replicate severe but plausible economic events and to have regard to risks which would not be evident through the use of parallel shocks alone.
- Interest income sensitivity: the impact on 12-month future income arising from various interest rate shifts. Our risk appetite scenarios are based on parallel rate movements of 2% and of divergences of up to 1.15% between BBR 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 using contractual behavioural profiles.

We monitor our exposures to foreign exchange risk daily and do not maintain net exposures overnight in any currency other than pounds, beyond minimum amounts.

We have a FTP policy to ensure that market risk is a factor in the pricing of loans and deposits.

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

Risk Appetite
We perform a Market Risk Assessment Process on at least an annual basis, for the identification, measurement, management and monitoring of market risk in the banking book, which allows ALCO and ROC to:

- Determine our Market Risk Appetites;
- Appraise the methodology for our Market Risk Appetites; and
- Scrutinise and approve the modelling assumptions for our Market Risk Appetites.

Table 31 provides the increase or decrease in economic value of equity ('EVE') for upward and downward interest rate shocks.

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 2018	(3.4)	2.8
31 December 2017	(7.6)	7.1

12. Other Risks

12.1 Regulatory risk

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

In assessing this risk management considers the control mitigants in place, and the advantages inherent in having no legacy issues to resolve. Key mitigants are a strong, appropriately-resourced risk function, the simplicity of our product range and a culture of delivering unparalleled levels of service and convenience, to ensure the consistent delivery of good Customer outcomes; all of which have been positively acknowledged by the FCA in its Firm Evaluation of us. Additional controls include regular reporting of regulatory compliance oversight by the ERC and ROC.

- Compliance monitoring and outcomes testing programme in place and regularly reviewed.
- Control around Customer data and IT systems both internally and with outsourcing partners.
- Mandatory monthly regulatory training for all colleagues.
- A culture built on transparency and service focussed on delivering the right customer outcomes.
- Reward and recognition for all colleagues focussed on providing exceptional customer service and recognising risk, compliance and audit requirements.
- Training and Competency schemes for all Customer facing roles. Products and services offered pose a low regulatory risk.

An internal review alongside ongoing supervision by the PRA has helped to identify potential inconsistencies in our risk-weighting of certain non-retail loans. Given the adjustment to our RWAs to bring our assessment into line with regulatory guidelines, we are working with external advisers to implement changes to our regulatory reporting data processes and systems. Table 32 shows the impact of RWA adjustment.

Table 32: Impact of RWA adjustment

	31 December 2018		
Exposures subject to the Standardised Approach	Exposure Value £'million	RWA before adjustment £'million	RWA after adjustment £'million
Central governments or central banks	2,652	–	–
Institutions	188	38	38
Corporates	633	574	574
Retail	859	565	565
Secured by mortgages on immovable property	12,938	5,038	5,938
Covered bonds	507	51	51
Claims on institutions and corporates with a short-term credit assessment	134	66	66
Securitisation Position	3,061	595	595
Exposure at default	59	65	65
Items associated with particularly high risk	51	77	77
Other Exposures	622	591	591
Total	21,704	7,660	8,560

12.2 Conduct risk

We have no appetite for unfair customer outcomes. We provide customers with simple, fairly priced products delivered through unparalleled levels of services and convenience.

In assessing this risk, management considered the control mitigants in place and the advantages inherent in having no legacy issues to resolve. In addition, the simplicity of our product range and our culture of delivering unparalleled level of service and convenience to our customers help to ensure the consistent delivery of good customer outcomes.

Key controls include:

- A culture built on transparency and service
- Products and services offered being simple and transparent
- No sales incentive schemes in place
- Training and Competency schemes for all customer-facing roles
- Conduct risk training included in the mandatory training for all colleagues
- Close management of third party relationships
- Compliance Monitoring Programme in place and regularly reviewed
- Regular consideration of conduct risks at the business risk committees
- Close and regular oversight of conduct risk by the CEO, CRO and ERC

12.3 Financial crime risk

We set our risk appetite and approach within our policies and procedures to ensure compliance with its regulatory obligations. Monitoring and oversight is in place for systems and controls to affirm that they remain robust and effective. We regularly engage with the FCA, other regulators and industry bodies to proactively manage its financial crime risks.

Key controls include:

- Financial crime training included in the mandatory training for all colleagues, and enhanced in customer facing roles
- Financial crime oversight and assurance of the financial crime risk management framework in the business The development of Key Risk Indicators for management reporting, including the monitoring of risk appetite.
- Regular consideration of financial crime risks through a dedicated committee, with further provisions to Board level.
- Financial Crime Risk assessment, including impact assessment of each of the key risk areas to which we are exposed.
- Risk control assessment, evaluating the effectiveness of the control framework covering financial crime risks to which the business area is exposed.

12.4 Concentration risk

Concentration risk exists through having high or excessive exposures to certain counterparties, regions or sectors which can lead to a concentration of loss in the event of an adverse movement in the strength or creditworthiness of the borrower or security.

We actively assess and monitor our exposure to a range of characteristics, including sector, region, and security type. Concentration risks from lending activities are managed and controlled through the adoption of a concentration risk policy. Reported exposures against policy limits are reviewed and discussed on a monthly basis.

Although there is diversification within our portfolios and operations, there are certain features of our activity which contain an element of concentration:

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

Although we only operate within the UK and limits its focus on certain sectors, these sectors have been targeted due to our expertise and/or the security and other risk mitigants available.

Concentration risk of treasury assets is managed and controlled through the treasury large exposures policy.

12.5 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.

12.6 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.

12.7 Residual value risk

We do not take residual value risk.

13. Remuneration

13.1 Disclosure requirements

The Remuneration Committee ensures that we operate a remuneration process and implements a Remuneration Policy which is consistent with relevant regulatory guidance. According to PRA Supervisory Statement SS2/17 Remuneration, firms are divided into three proportionality categories based on relevant total assets for the purpose of identifying the applicable disclosure requirements.

We fall into Tier 3 category for the year ended 31 December 2018 and our Remuneration Policy was based on the disclosure rules of that corresponding proportionality category. We will move to Tier 2 category for the year 2019, therefore our remuneration policy will be updated in due course to meet applicable disclosure requirements.

13.2 Remuneration policy

We have a Remuneration Policy in place which outlines the overall approach towards managing remuneration for Executive and Non-Executive Directors. The Nomination Committee and Remuneration Committee will consider the policy annually to ensure that it remains aligned with business strategy and the regulatory framework to which we are subject.

We have a simple approach to compensation which reinforces our model by rewarding the right behaviours and outcomes for customers and the business, focusing on long term growth and discouraging unnecessary risk taking. Our reward principles are to:

- Pay fair salaries and offer fantastic career and growth opportunities in an AMAZEING culture.
- Make everyone an owner; align them to our vision for the long term.
- Reward people based on how we perform and also on how they behave and deliver; both as part of the team and as an individual.
- Keep reward as simple as possible with one approach for all.
- Take a retail approach to variable reward – we do not offer excessive cash bonuses or linear incentives which can skew behaviours and encourage unnecessary risk taking.

13.3 Link between pay and performance

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

- Financial
- Risk
- Operations and IT
- Customers
- People

We also consider risk adjusted financial performance in setting the overall pool.

Executive Directors are awarded variable remuneration for a year on a discretionary basis taking into account the following factors over the year amongst others:

- Individual behaviours and performance based on their AMAZEING Reviews – these performance targets are agreed at the beginning of the year and are reflected in our Balanced Scorecard
- Overall contribution to our culture, performance and success

For Identification of Material Risk Takers ('MRTs') and Composition of Remuneration for MRTs, please refer to the Remuneration Code and Annual Disclosure Statement for Year ended 31 December 2018 which can be found on our website.

For the details of our remuneration disclosures, please refer to the 2018 Remuneration Report within our 2018 Annual Report and Accounts.