growing metro bank safely and sustainably

Risk management framework

Metro Bank seeks to adopt best practice in corporate governance, risk management and control appropriate to the size and complexity of the business. Given the nature of the activities undertaken by Metro Bank, principal risks and uncertainties the Bank faces are:

- strategic risk;
- credit risk;
- market risk including interest rate risk;
- liquidity risk;
- conduct risk;
- compliance and regulatory risk;
- operational risk; and
- financial crime.

The Board has ultimate responsibility for setting the Bank's strategy, corporate objectives and risk appetite. The strategy and risk appetite take into consideration the interests of customers, shareholders and other stakeholders. The Board specifically approves the level of risk which the Bank is willing to accept, and ensures there is an adequate framework in place for reporting and managing those risks. It is responsible for maintaining an appropriate control environment to manage the principal risks, and for ensuring the capital and liquidity resources are adequate to achieve the Bank's objectives within its risk appetite.

The Board has delegated responsibility for reviewing the effectiveness of the Bank's internal controls to the Audit Committee. The Audit Committee monitors and considers the internal control environment, focusing on operational risks, internal and external audits and credit assurance, and is assisted in its oversight role by Internal Audit. Internal Audit undertakes both regular and ad hoc reviews of risk management controls and procedures, the results of which are reported to the Audit Committee.

The Risk Oversight Committee assists the Board in providing leadership, direction and oversight with regard to the Bank's risk governance and management, and also assists the Board in fostering a culture within the Bank that emphasises and demonstrates the benefits of a risk-based approach to risk management and internal control.

The Bank's risk management policies are established to identify and analyse the risks faced by the Bank, to set appropriate risk limits and controls and to monitor risks and adherence to limits. The risk management policies and controls are reviewed regularly to reflect changes in market conditions and the Bank's activities. Through training and management standards and procedures, the Bank aims to develop a robust and effective control environment in which all colleagues understand their roles and obligations.

Metro Bank's Chief Risk Officer ("CRO") is accountable for leading the Risk function, which is independent from the Bank's operational and commercial functions. She is responsible for ensuring that appropriate risk management processes, policies and controls are in place, and that they are sufficiently robust, thereby ensuring that key risks are identified, assessed, monitored and mitigated. The CRO is also responsible for providing assurance to the Board and Directors that the principal risks are appropriately managed and that the Bank is operating within its risk appetite. The CRO has access and a dotted reporting line to the Chairman of the Risk Oversight Committee.

The Bank operates a model with three lines of defence for risk management:

- The first line of defence is operational management, managing risk by maintaining appropriate systems and controls that are operated and effective on a daily basis.
- The second line of defence comprises the Risk Management function, providing governance and oversight for all significant risk categories, such as credit risk, compliance and conduct risk, operational risk, market risk, interest rate risk and liquidity risk.
- The third line of defence is Internal Audit, providing independent assurance through Internal Audit reviews, the results of which are reported to the Audit Committee.

Effective risk management is core to Metro Bank's approach to doing business.

A description of strategic, credit, market, liquidity, conduct, compliance and regulatory, operational and financial crime risk and how they are managed is set out below.

Strategic risk

Strategic risk is the risk that Metro Bank fails to achieve short and long-term business objectives because of a failure to maintain its unique culture; maintain its differentiated model through delivering unparalleled levels of service and convenience; or develop the products, capabilities, and competitive position necessary to attract new customers, compete effectively and withstand market volatility. This could result in a failure to create FANS or to deliver outcomes expected by stakeholders (customers, colleagues, shareholders, investors, communities and regulators).

The Bank manages this risk through frequent consideration of a broad range of management information and key performance and risk indicators at Business Risk Committees, the Executive Leadership Team and the Board. The Bank also conducts regular reviews of performance against the business plan – also at the Executive Leadership Team – and these will provide early warnings of where plan delivery is at risk.

Credit risk

Credit risk is the risk of financial loss due to an obligor's failure to meet the terms of any contract or failure to perform as agreed. The Bank has detailed lending policies to ensure credit risk-taking is based on sound credit risk principles, including sector and concentration limits. Credit risk is overseen by the CRO, Credit Sanctioning Committee, Credit Policy and Appetite Committee and the Risk Oversight Committee.

The CRO is responsible for managing the Bank's credit risks through the following:

- Defining the Enterprise Risk Management structure and quantifying the Bank's risk appetite.
- Formulating credit policies covering collateral requirements, credit assessment, risk grading and reporting, documentary and legal procedures and compliance with regulatory and statutory requirements.
- Establishing the authorisation structure for the approval and renewal of credit facilities.
- Limiting concentrations of exposure to counterparties and industries (for loans and advances and similar exposures) and by issuer, credit rating and market liquidity (for investment securities).

The Bank aims to have a well-balanced loan portfolio, through the economic cycle, weighing risk and reward appropriately in lending decisions. The Bank has detailed lending policies to ensure credit risk-taking is based on sound credit risk principles. Limits are set for each borrower, together with large exposure limits consistent with prudential regulatory rules. The Bank also measures concentration risk, loan arrears and bad debts. For quantification of credit risk, Metro Bank uses the Standardised Approach assessed under Basel II, Pillars 1 and 2. The Bank is in the process of developing more sophisticated internal models in order to seek regulatory approval to apply the Advanced Approach to the calculation of credit risk exposures in due course.

Market risk

Market risk is the risk that changes in market prices, such as interest rates or prices of investment securities, will affect the Bank's income or the value of its holdings of financial instruments. The objective of the Bank's market risk management strategy is to manage and control market risk exposures within acceptable parameters to ensure the Bank's solvency while optimising the return on risk.

Day-to-day management of market risk is the responsibility of the Treasury team with oversight from Treasury Risk.

The Bank aims to minimise earnings shocks or surprises. The Bank does not undertake proprietary trading activities and only holds high-rated investment securities. Management monitors exposures to price risk and movements in investment value on a regular basis through Asset and Liability Management Committee ("ALCO") and regular Treasury reporting.

The Bank does not sell derivatives or other complex products to customers.

Liquidity risk

Liquidity risk is the risk that the Bank will encounter difficulty in meeting obligations associated with its financial liabilities that are settled by delivering cash or another financial asset, or will incur a disproportionate cost in meeting said obligations.

The Bank aims to hold a prudent level of liquidity to cover unexpected outflows and ensuring it would be able to meet financial commitments for an extended period. Recognising the potential difficulties in monetising certain assets, higher-quality targets for liquid assets are set for the initial part of a stress period. The Bank has assessed the level of liquidity necessary to cover both systemic and idiosyncratic risks and an appropriate liquidity buffer is maintained at all times. As well as cash and balances at the Bank of England, the Bank holds a range of marketable assets, including covered bonds and government debt, which are highly liquid assets. The Bank also maintains a balance sheet structure that limits reliance on potentially volatile sources of funding.

The Bank's Board of Directors sets the Bank's risk appetite and policy for managing liquidity risk and delegates responsibility for oversight of this policy and its implementation to the ALCO. The Treasury team manages the Bank's liquidity position on a day-to-day basis under the oversight of the Chief Financial Officer and ALCO. Detailed daily management information is circulated to the Treasury team and relevant members of the Executive Leadership Team regarding the outcome of the Bank's combined stress-test scenario. The Bank's approach is to ensure that it can meet payments as they fall due – in both normal conditions and in the event of a severe liquidity stress, and that it can survive a severe liquidity stress event and continue as a going concern.

Conduct risk

Conduct risk is the risk that the Bank's operating model, culture or actions result in unfair outcomes for customers. Effectively managing risks that may impact our customers is a priority for the Bank, which manages conduct risk consistently with its overall risk appetite and aligned with its strategy. Conduct risk may arise from any aspect of the way the Bank's business is conducted and the Bank's aim is to avoid business conduct that may result in unfair outcomes for its customers.

The Bank has a range of controls in place to mitigate this risk. There are advantages inherent in the combination of its transparent, service-led business model and absence of legacy issues. The simplicity of the Bank's product range and its culture of delivering unparalleled levels of service and convenience to its customers help to ensure the consistent delivery of fair customer outcomes. This has resulted in a low level of reportable complaints, which is below the industry average. The Bank constantly analyses the root cause of complaints and underlying trends to identify opportunities to improve service provision while delivering consistently fair outcomes for its customers.

RISK FACTORS AND MANAGEMENT CONTINUED

Compliance and regulatory risk

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

The Board is focused on responding effectively and in a timely manner to changes in the regulatory environment to ensure that compliance with regulatory requirements is maintained. The Bank allocates appropriate resource to ensure that it continues to achieve regulatory compliance.

Operational risk

Operational risk is the risk of direct or indirect impact from failed or inadequate processes, people or systems, or exposure to external events. The impact can be financial or non-financial in nature. Non-financial impact includes customer detriment, regulatory action or reputational consequences.

The Bank aims to maintain robust operational systems and controls and to be able to respond to unexpected events in an organised and timely manner though rigorous planning and testing. Each business line undertakes an assessment of key risks and risk exposures. Each risk exposure is assessed to determine the appropriate controls. In addition, the three lines of defence model is used: firstly, business owners own and manage risks and controls; the second line sets standards and defines tools to be used to manage risk; and the third line provides independent assurance over the other two lines of defence.

The implementation of this approach takes the form of the first line of defence maintaining a risk and control self-assessment for each business area, recording that area's risks rated by impact and likelihood, before and after taking into account any mitigating controls.

Cyber security

Cyber-crime continues to pose a significant threat to the financial services industry as a whole and the Bank has invested in technology and expertise to strengthen defences in this area. A dedicated Information Security team is responsible for leading the work in this area, including anti-phishing, data loss prevention and overseeing patching of the IT estate.

The Bank partners with industry-leading experts to ensure that any risk management approach is robust and proportionate, and evolves in line with developing threats.

The Bank is a member of several industry forums that share threat intelligence, enabling it to keep abreast of external developments that carry the potential to affect operations. The Bank also collects intelligence and assesses its exposure, leading to the implementation of preventative measures. It continues to invest in cyber security.

Financial crime

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

The Bank is required to have in place effective procedures, systems and controls to detect and prevent financial crime. The Bank is committed to complying with its legal and regulatory responsibilities in relation to financial crime, and has no appetite for non-compliance.

The Bank's growth plans continue and it is dedicated to maintaining a robust control environment that enables it to respond effectively to emerging financial crime threats, which are becoming more frequent, more varied and more innovative. The need to protect Metro Bank, its customers, assets and society from the impact of financial crime has never been more challenging. The Bank constantly reviews its internal systems and processes to ensure they provide adequate protection against new and emerging threats. It has induction and training programmes for Metro Bank colleagues covering all aspects of financial crime to support them in protecting customers and assets.

The Bank has adopted a robust framework. It assesses and monitors risks in relation to customers, relationships, transactions and payments, with the purpose of ensuring there are tailored, risk-based systems and controls in place to manage potential risks, and avoid losses, reputational impacts or degradation of customer experience.

Through the three lines of defence model the Bank addresses the oversight and monitoring of the systems and controls through the following key areas: (i) the Bank's risk and control self-assessment; (ii) dedicated, specialist colleagues operating the systems and controls in the first line of defence, overseen by the second line Anti-Money Laundering ("AML") Risk team; and (iii) Internal Audit. In addition, key risk indicators are in place with regular reports through the appropriate Bank Committees and the Board.

The Bank has made significant investment to enhance systems, controls and people to support the execution of its business strategy and to ensure it has robust and sustainable models as it grows. This includes the implementation of a new monitoring and surveillance system for anti-money-laundering, counter terrorist financing and sanctions. The Bank anticipates further enhancements over the coming months as result of significant change in financial crime regulation.

Emerging risks and mitigations

Metro Bank has identified a number of emerging risks that have the potential to impact the activities of the Bank and they include:

Compliance and competition regulation

Increased use of market studies as a regulatory tool is likely, following the market studies on cash savings and credit cards. The Bank's key risk mitigation in this respect is to continue to place the customer at the heart of its business.

Key areas of regulatory focus affecting the Bank in 2017 include the Payment Services Directive and the remaining requirements under the Senior Managers and Certification regimes. Other domestic initiatives captured in the Financial Conduct Authority's ("FCA") Mission Statement include an increased focus on vulnerable customers, behavioural economics, pricing for risk and a planned ageing population strategy.

Further studies from the FCA and Competition and Markets Authority are likely to be announced as the year progresses. Digital channels, cyber risk and systems infrastructure and resilience are likely to remain high on the regulatory agenda, as will changes to the macroeconomic environment.

Financial crime prevention
To tackle money laundering and corruption and recover the proceeds of crime and counter terrorist financing, the Anti Money Laundering Directive IV is due to take effect in July 2017 and The Criminal Finances Bill is being considered by Parliament.

Prudential regulation
The Bank of England will be phasing in the setting of a minimum requirement for own funds and eligible liabilities ("MREL"). This is applicable to all UK banks and full compliance must be in place by 2022. The Prudential Regulatory Authority ("PRA") has also introduced new underwriting standards for buy-to-let mortgage contracts which came into force in part in January 2017, with the remainder in force in September 2017.

Changes to data protection legislation
These will result in increasing regulatory scrutiny on the Bank's data processing activities. Metro Bank is investing significantly in a Bank-wide General Data Protection Regulation ("GDPR") implementation project which commenced in January 2017.

Growth
The pace of growth experienced by Metro Bank has the potential to increase operational risk. As a result, the Bank has invested heavily in people and infrastructure to meet this challenge. Metro Bank's superior customer experience is supported by an end-to-end technology infrastructure that provides a single customer view, allowing enhanced customer service and colleague efficiency.

Metro Bank's technology stack enables colleagues to focus exclusively on creating a great customer experience. The Bank uses that technology to simplify and accelerate customer processes.

Data integrity and systems resilience
Reliance on systems infrastructure is growing, with any weaknesses causing a greater impact. The Bank will continue to invest to ensure it meets all applicable and new standards and uses third parties that ensure a high level of protection and resilience. The creation of a Chief Data Officer in 2016 was designed to ensure that an appropriate framework and controls are in place to manage the increasing risks associated with data management.

Digital
Internet and mobile technologies are changing the way banks interact with customers and increasing our reliance on technology and infrastructure. Metro Bank is investing in its digital platforms and building resilient and secure technologies. Technological evolution will require the Bank to continue to be vigilant from a security perspective, and also to assess and review our conduct approach on an ongoing basis.

Changes in accounting standards
The new reporting requirements under International Financial Reporting Standards 9 introduce new credit loss models, and a programme to deliver models and policies/standards to fulfil the requirements is underway.

Political changes
The political environment in the UK, Europe and on a global scale impacts Metro Bank's operations. Recent political developments, including Brexit, have an as yet unknown impact on the way the Bank operates and serves customers.

This report was approved by the Board and was signed on its behalf by:

Vernon W. Hill, II
Chairman
2 March 2017

VIABILITY STATEMENT

In accordance with provision C.2.2 of the revised UK Corporate Governance Code, the Board has assessed the prospects of the Group and Parent Company over a longer period than the 12 months that has in practice been the focus of the "going concern" provision.

Whilst the Bank prepares a forecast spanning a seven year period, the Directors concluded that a four-year period was appropriate for the assessment, as it is the period over which the financial forecasts have greatest certainty, and is in line with the period management consider when determining the 2020 vision for the Bank. These forecasts are updated annually and reflect the Group's established strategy of creating FANS through our unique culture and integrated model of stores and technology, in order to raise low-cost, sticky deposits and low-risk diversified lending.

Key assumptions included in the model include store, deposit and lending growth, as well as remaining appropriately capitalised. Over the forecast period, we expect to raise debt to fund our anticipated growth.

Forecasts were subject to appropriate downside stress and sensitivity analysis over the assessment period, taking account of the Group's current position, the Group's experience of managing change and the impact of a number of severe yet plausible scenarios, based on the principal risks outlined in the Risk factors and management section of this report (page 24 to 27 of the Annual Report).

Based on the results of this analysis, the Directors have a reasonable expectation that the Group will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment.