



## FINAL NOTICE

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To: **Metro Bank plc (Firm Reference Number: 488982)**

Date: **21 December 2021**

### 1. ACTION

- 1.1. For the reasons set out in this Notice, the PRA imposes a financial penalty on Metro Bank plc (“Metro Bank” or “the Firm”) of £5,376,000 for breaching Fundamental Rules 2 and 6 of the PRA Rulebook during the period 13 May 2016 to 23 January 2019 (“the Relevant Period”).
- 1.2. The Firm agreed to settle during the Discount Stage of the PRA’s investigation. As a result, Metro Bank qualified for a 30% settlement discount under the PRA Settlement Policy. Were it not for this discount, the PRA would have imposed a financial penalty of £7,680,000.

### 2. SUMMARY OF REASONS FOR ACTION

#### Background

- 2.1. Metro Bank is a UK bank that was established in 2010, and is regulated by the PRA for prudential purposes and by the FCA for conduct matters. Metro Bank is a “challenger bank”, founded with the aim of competing directly with older, more established banks. It offers retail, business, commercial, and private banking services. Metro Bank achieved its first annual profit in 2017. Since its foundation, the Firm has rapidly expanded and now has a network of 78 branches, servicing 2.4 million customer accounts across the UK with a total loan book of £12.3 billion.
- 2.2. During the Relevant Period, Metro Bank was assigned as a Category 3 firm but as it grew it was recategorised as a Category 2 firm (from June 2018). A Category 3 firm is

a deposit-taker whose size, interconnectedness, complexity, and business type gave it the capacity to cause minor disruption to the UK financial system by failing or by carrying on its business in an unsafe manner, but where difficulties across a whole sector or subsector had the potential to generate disruption. A Category 2 firm is a significant deposit-taker whose size, interconnectedness, complexity, and business type give it the capacity to cause some disruption to the UK financial system (and through that to economic activity more widely) by failing, or by carrying on its business in an unsafe manner.

- 2.3. On 23 January 2019, Metro Bank announced to the market that it was making an adjustment to its assessment of its risk weighted assets (“RWA”) for December 2018 of approximately £900 million (“the RWA Adjustment”). The Firm’s announcement also stated that its profits for 2018 were below expectations due to tougher trading. The effects of the RWA Adjustment combined with other factors to pose a risk to the PRA’s advancement of its primary objective to promote the safety and soundness of PRA authorised firms.

#### **The relevant regulatory framework**

- 2.4. A key part of the regulatory response to the global financial crisis has been enhanced prudential standards relating to firms’ capital adequacy. These standards are intended to ensure that firms hold sufficient funds to absorb losses in periods of stress.
- 2.5. Pursuant to the PRA’s approach to banking supervision, the PRA determines a minimum regulatory capital level and buffers on top of this, as applicable, expressed in terms of the international standards developed by the Basel Committee on Banking Supervision (the “Basel Committee”), and collectively called Basel III. The UK capital framework is described in “The Prudential Regulation Authority’s approach to banking supervision, October 2018.”<sup>1</sup>
- 2.6. One driver of the minimum regulatory capital level is a bank’s assets. Because not all assets have the same risk, a bank’s assets are weighted based on the risk that each asset presents. The higher the amount of RWA that a firm has, the more capital it is required to hold.
- 2.7. Under the Capital Requirements Regulation (575/2013) (“CRR”) and in accordance with the PRA Rulebook, firms are required to submit periodic information to the PRA, including reports as part of the Common Reporting (“COREP”) framework, a reporting

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<sup>1</sup> <https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/approach/banking-approach-2018.pdf>

framework introduced to standardise the reporting of capital requirements and prudential regulatory information. These COREP reports include (amongst others) quarterly reporting on a firm's current assessment of its RWA.

- 2.8. There are different approaches available for the assessment of RWA. Under the standardised approach that applied to Metro Bank throughout the Relevant Period, firms are required to take the value of their assets, assign them to the appropriate category depending on the type of exposure and the type of counterparty, and apply to the assets in each of those categories the percentage prescribed in the PRA Rulebook.
- 2.9. Whilst there are 17 exposure categories defined under Article 112 of the CRR, this Notice is concerned with certain exposures falling within the broader exposure class of "*exposures secured by mortgages on immovable property*"; namely:
- (1) exposures fully and completely secured by mortgages on residential property (article 125 of the CRR);
  - (2) exposures fully and completely secured by mortgages on commercial immovable property (article 126 of the CRR), referred to in this Notice as "CLIP loans"; and
  - (3) exposures secured by mortgages on immovable property, which includes mortgages secured on real estate that do not fall into Articles 125 or 126 (article 124 of the CRR).

#### CLIP loans

- 2.10. CLIP loans are loans that are fully and completely secured by mortgages on commercial immovable property. Under Article 126 of the CRR, the prescribed risk-weighting for such loans was 50%. However, in implementing the CRR, the PRA exercised its discretion to impose a stricter regulatory capital treatment on CLIP loans. Under the PRA's rules, a 50% risk weight could only be assigned to CLIP loans "where annual average losses stemming from lending secured by mortgages on commercial property located in the UK did not exceed 0.5% of risk-weighted exposure amounts *over a representative period*". When this test is not met, a 100% risk weight should be assigned under the fallback risk weighting in Article 124 CRR. For certain categories of loan including CLIP loans, the applicable risk weight percentage can be reduced by a further multiplier for loans made to small or medium sized entities where certain conditions are met on an ongoing basis (the "SME Supporting Factor").

### PBTL loans

- 2.11. Metro Bank categorised certain of its loans as professional buy-to-let loans (referred to in this Notice as “PBTL loans”). PBTL loans are not defined, or treated as a separate class of exposure, under the CRR and so how they should be allocated under CRR articles is dependent on how a firm has defined them.
- 2.12. The following exposure classes may be relevant to Metro Bank’s treatment of PBTL loans: exposures fully and completely secured by mortgages of property, that are subject to a risk weighting of 35% (under article 125 of the CRR); CLIP Loans that are subject to a risk weighting of 100% (as described at paragraph 2.10 above); and exposures secured by mortgages on immovable property, which includes mortgages secured on real estate that do not fall into articles 125 or 126, that are subject to a risk weighting of 100% (under article 124 of the CRR).

### **The Firm’s RWA reporting**

- 2.13. As set out below, prior to December 2018, Metro Bank was risk weighting CLIP loans at 50% and certain PBTL loans at 35% or less. Metro Bank should have been risk weighting CLIP loans and certain PBTL loans at 100% and the identification of these (and other, less material) errors (collectively, “the RWA errors”) led to Metro Bank making the RWA Adjustment that the Firm publicly announced on 23 January 2019. Throughout the Relevant Period, responsibility for calculation of Metro Bank’s RWA figures and reporting of these to the PRA sat with the Regulatory Reporting Team (“RRT”) within the Firm’s Finance function.
- 2.14. In May 2016, the PRA wrote to the Firm noting Metro Bank’s high resubmission rate for certain regulatory returns and requesting an action plan to resolve the issue. These concerns did not materially impact Metro Bank’s capital position and were not understood within Metro Bank’s Finance function to relate to its approach to risk weights or to its COREP reporting. Metro Bank sought to address the PRA’s concerns through the implementation of a new regulatory reporting system, changes to RRT personnel and implementation of additional controls.

### Internal Audit review of COREP reporting

- 2.15. In September 2016, the PRA informed Metro Bank that it had been selected to participate in a PRA thematic project focusing on COREP reporting and asked the Firm’s Internal Audit function (“Internal Audit”) to conduct a review of its COREP reporting (“the COREP audit”). The COREP audit report was finalised in June 2017,

and identified a number of errors, including the incorrect risk weighting of certain commercial real estate loans (“CRE loans”) between 25% and 50%, instead of at 100%. This had resulted in Metro Bank understating its capital requirement by approximately £12 million in each of the June 2016 and September 2016 COREP reports it submitted to the PRA, which did not have a material impact on the Firm’s total RWAs or capital requirement.

- 2.16. The report cited “*a lack of documented policies and procedures*”, “*a lack of skilled resources to interpret the rules*”, and “*upstream data inaccuracies*” as the main causes of the errors. The report also identified a lack of review or oversight of COREP returns. However, the report noted that a need for significant improvement had already been identified by management before the COREP audit.
- 2.17. Although the COREP audit identified incorrect risk weighting of CRE loans, it did not identify the broader issue that Metro Bank was incorrectly risk weighting CLIP loans and PBTB loans (i.e. the RWA errors that led to the RWA Adjustment in January 2019), which was to have a larger impact on its RWA calculation. Rather, the COREP audit report stated that Metro Bank had been “prudent” in risk weighting CLIP loans at 50%. Metro Bank continued to submit COREP returns to the PRA on an inaccurate basis. Metro Bank’s last inaccurate COREP return was its quarterly report covering the three months to 30 September 2018.
- 2.18. Prior to finalisation of the COREP audit report, Metro Bank’s management agreed actions required to address the issues identified and presented the findings of the COREP audit to the Firm’s Audit Committee later in June 2017. Metro Bank’s management confirmed to the Audit Committee that ensuring the accuracy and timeliness of COREP reporting was a priority and that recent personnel changes and improvements in data and controls would lead to a “*rapid and significant improvement in delivery*”. Metro Bank provided the PRA with the June 2017 COREP Audit report and the relevant Audit Committee minutes in July 2017. Progress against management actions was reported to and overseen by the Audit Committee, with the actions closed in Q1/Q2 2018.
- 2.19. In March 2018, the PRA requested confirmation from Metro Bank that work to remediate the COREP audit findings was underway, which the Firm provided. The work undertaken to address the issues identified by the COREP audit, and the Firm’s separate work stream (regarding its application for PRA approval to adopt an advanced internal ratings-based approach for calculating RWA (“AIRB”)) led some individuals

within Metro Bank's Risk and Finance functions to explore concerns that there may be issues with the Firm's risk weighting of other portfolios of commercial loans that had not been identified or remediated as a result of the COREP audit, including in respect of CLIP loans.

#### Engagement of the First Consultant

- 2.20. In April 2018, Metro Bank engaged an external consultancy firm ("the First Consultant") to prepare a set of flow diagrams setting out a structured series of questions (referred to as "decision trees") to assist the Firm in classifying loans correctly for the purposes of (amongst other things) calculating RWA under both the standardised and the AIRB approach.

#### Identification and escalation of the RWA errors

- 2.21. The First Consultant presented to Metro Bank draft decision trees in May 2018, which were finalised in August 2018. By 31 May 2018, certain individuals in Metro Bank's Finance and Risk functions had identified from their work with the First Consultant that the Firm's risk weighting classifications for all CLIP loans were incorrect and should have a risk weighting of 100%. In addition, concerns were raised by certain individuals in Metro Bank's Finance and Risk functions as to whether Metro Bank was correct in risk weighting all BTL loans at 35%, without considering if the requisite conditions were met in relation to its PBTL loan portfolio. The details of the nature of the issue were not escalated to senior management at this time.
- 2.22. During the period May 2018 to August 2018, members of the Firm's Finance, Risk and Commercial Lending functions continued to discuss the correct approach to risk weighting two portfolios of commercial loans: CLIP loans and PBTL loans. At the same time, the PRA raised questions with Metro Bank regarding the Firm's commercial loans risk weights and Metro Bank explained in July 2018 that these were under review but may change because of the First Consultant's decision trees exercise.
- 2.23. The PRA, in a separate exchange, informed Metro Bank that the application of a 44% average risk weighting to the "CRE Other" loan book appeared low on the basis that it included unsecured commercial loans and commercial investment loans.
- 2.24. In its response to the PRA, Metro Bank stated that both approaches were under review as part of its ongoing asset classification and risk weighting work but that, as a result of that work, the Firm now believed both risk weightings to be inaccurate.

- 2.25. On 24 August 2018, a member of the Firm's Credit Risk team informed members of Metro Bank's senior management that the Firm's risk weighting of CLIP and PBTL loans was substantially incorrect and that, based in part on a sampling exercise, they estimated that correcting the risk weighting would result in an increase of approximately £900 million in RWA. This was the first occasion on which the potential scale and impact of the RWA errors was escalated to the Firm's senior management.
- 2.26. On 6 September 2018, Metro Bank attended a meeting with the PRA at which the PRA raised concerns regarding Metro Bank's miscalculation of risk weightings for certain types of commercial loans. In response, Metro Bank said to the PRA that the miscalculation was "*clearly an error on our part and was being fixed*".
- 2.27. The PRA's concerns raised at this meeting were reflected in its letter to Metro Bank of 10 September 2018, which noted that the bank was remediating the classification of commercial risk weights and required (among other things) that the Firm submit the results of its commercial risk weighting exercise to the PRA once complete together with an attestation from members of the Firm's senior management confirming the accuracy of the Firm's regulatory reporting.
- 2.28. The PRA's letter and the likely need for adjustments to Metro Bank's risk weightings were discussed at the Board, Audit Committee and Risk Oversight Committee meetings in September and October 2018. On 21 September 2018, Metro Bank asked another external consultant ("the Second Consultant") to support a thorough review of the Firm's risk weighting of commercial lending and enable an attestation to be provided to the PRA.
- 2.29. In early October 2018, the PRA agreed to Metro Bank's request not to change the basis of its COREP reporting, pending the outcome of the Firm's ongoing review.

#### Engagement of the Second Consultant

- 2.30. On 16 October 2018, Metro Bank formally engaged the Second Consultant to review and remediate the Firm's policies, procedures and controls in relation to the calculation of RWA and COREP reporting. This review was to be conducted in three phases that spanned a period of nine to ten weeks in total.
- 2.31. On 1 November 2018, the Second Consultant, having performed an initial two-week review of the RWA calculation and COREP reporting process, concluded that "*[t]he most significant mis-statement in the RWA calculation is due to the incorrect risk weighting of commercial property at 50% rather than 100%. Impact c. £600 RWA [...]*"

*[C]urrently it is virtually impossible to evidence the integrity of the RWA calculation or the COREP reports. This is because there are multiple gaps in the controls framework at every stage of the process, from data sourcing through to report generation.”*

- 2.32. On 20 December 2018, the Second Consultant informed Metro Bank that *“it is estimated that, in aggregate, the issues identified in the RWA calculation will increase RWA by £0.9-1.0bn, and an increase in capital requirements of c. £100m, at a target capital ratio of 12.5%.”* In addition to the need for Metro Bank to adjust the risk weighting of CLIP loans, the Second Consultant’s review confirmed that adjustment to the risk weighting of PBTL loans was required, as well as several other less significant RWA adjustments. The review identified a number of deficiencies in Metro Bank’s processes and procedures, systems and controls in place to assess and report on RWA, including deficiencies in the data gathered, manual intervention required, lack of documentation and lack of effective oversight of the process.

#### The RWA Adjustment

- 2.33. During January 2019, Metro Bank engaged with the PRA regarding the results of the Second Consultant’s review. On 23 January 2019, Metro Bank issued its Full Year 2018 Results Preview and Trading Update. The announcement itself did not give specific details regarding the re-categorisation and RWA Adjustment. Instead, it provided a revised approximation of £8.9 billion for its RWA:

*“Risk weighted assets at full year are expected to be approximately £8.9bn with the increase driven by both net loan growth and an adjustment in the risk weighting of certain commercial loans secured on property and certain specialist BTL loans to large portfolio landlords.”*

- 2.34. The RWA Adjustment was driven by:

- (1) an increase of £563 million in RWA due to Metro Bank adjusting the risk weighting of CLIP Loans from 50% to 100%. Prior to this point, Metro Bank was not applying a risk weight of 100% to all of its CLIP loans, as required by the PRA;
- (2) an increase of £312 million in RWA due to Metro Bank adjusting the risk weighting of certain PBTL loans from 35% to 100%. Prior to 23 January 2019, Metro Bank applied a 35% risk weight to certain PBTL loans where it should have been applying a 100% risk weight; and
- (3) an increase of approximately £25 million due to a number of less material adjustments.

- 2.35. Later the same day, Metro Bank explained on an analyst presentation call that the estimated increase in RWA included adjustments of “around £900 million” due to errors in Metro Bank’s risk weighting of certain commercial loan and PBTL portfolios. The effects of the RWA Adjustment combined with other factors to contribute to a risk to the PRA’s advancement of its primary objective to promote the safety and soundness of PRA authorised firms.
- 2.36. On 24 January 2019, Metro Bank shared with the PRA a regulatory interpretation document prepared by the Second Consultant explaining the PBTL treatment that had been adopted.

### Remediation

- 2.37. In light of the findings of the Second Consultant’s review, Metro Bank undertook a programme to remediate the RWA errors and identify and address root causes. In May 2019, Metro Bank shared with the PRA the findings and recommendations arising from this review. The Firm’s remediation exercise continued throughout 2019 and drew on the support of external consultants in order to deliver changes to the Firm’s governance and control environment (including to its policies, procedures, resourcing, roles and responsibilities, data quality, culture, reporting, systems and record keeping). This exercise concluded with an external assurance review of Metro Bank’s RWA process, which included a line-by-line review of the Firm’s loan book to ensure the accuracy of the RWA figures reported by Metro Bank. Metro Bank calculates the total cost of its remediation exercise to have been over £15m.
- 2.38. The PRA and FCA also requested that Metro Bank undertake a review of its Enterprise Risk Management Framework. The RMF & Risk Culture review was carried out by the Second Consultant, with the findings and recommendations shared with the PRA in June 2019. This review informed enhancements to governance and risk management that were completed as part of Metro Bank’s remediation exercise in 2019.

## **3. BREACHES AND FAILINGS**

- 3.1. The PRA considers that, during the Relevant Period, Metro Bank breached Fundamental Rules 2 and 6 of the PRA Rulebook.
- 3.2. Metro Bank pursued a rapid growth and expansion plan and during the Relevant Period increased its number of high-street branches and customers, growing core deposits and lending. However, Metro Bank failed to ensure the commensurate development of and investment in governance arrangements and systems and controls relating to its

COREP reporting, which it failed to design, implement or operate effectively in a number of respects.

- 3.3. As a result, Metro Bank's arrangements in respect of regulatory reporting to the PRA were inadequate to ensure accurate and reliable reporting for an organisation of Metro Bank's size, such that its COREP reporting to the PRA was inaccurate. As set out above, the Firm's application of risk weightings to certain commercial loans resulted in the RWA Adjustment.

### **Fundamental Rule 2**

- 3.4. Fundamental Rule 2 requires a firm to conduct its business with due skill, care and diligence.
- 3.5. During the Relevant Period, Metro Bank breached PRA Fundamental Rule 2 because it failed to take sufficient care to ensure that it complied with its COREP reporting obligations. Despite the PRA requiring Metro Bank to conduct an internal audit of its COREP reporting, the findings of the COREP audit in June 2017 identified issues related to CRE classification but failed to identify the full extent of the RWA errors. In particular:
- (1) Metro Bank failed to ensure it interpreted the applicable regulatory rules and guidance on RWA classification with due skill, care and diligence. Due to its failure to correctly interpret the relevant requirements, Metro Bank incorrectly:
    - (a) risk weighted business loans secured on commercial property at 50% rather than 100%;
    - (b) risk weighted certain PBTL mortgages at 35% rather than 100%; and
    - (c) excluded the undrawn portion of certain property development loans and other facilities from its RWA calculation (among other errors).
  - (2) Metro Bank failed to take sufficient skill, care and diligence to ensure that it had implemented the relevant systems and controls appropriate for a firm of its size and complexity. Metro Bank failed properly to identify the RWA errors until August 2018, arising from the First Consultant's work on a project unrelated to RRT's work.

## **Fundamental Rule 6**

- 3.6. Fundamental Rule 6 requires that a firm organises and controls its affairs responsibly and effectively.
- 3.7. During the Relevant Period, Metro Bank breached Fundamental Rule 6 because it failed to organise and control its affairs responsibly and effectively in order to be able to comply with its COREP reporting requirements. These failings related to: (i) governance and oversight; (ii) controls; and (iii) investment and data.

### Governance and oversight

- 3.8. Metro Bank's governance and oversight arrangements relating to its COREP reporting fell significantly below the standards the PRA expects of a firm of Metro Bank's size and scale. In particular:
- (1) Metro Bank failed to ensure effective oversight and challenge of its approach to COREP reporting:-
- (a) Outside of the Finance Function, Metro Bank failed to clearly assign the roles and responsibilities of senior individuals or the Firm's Executive and Board level committees in relation to the review, challenge and oversight of RWA calculation and reporting. Furthermore, members of Metro Bank's senior management lacked sufficient awareness and understanding of the Firm's policies and procedures relating to its regulatory reporting control framework. This limited the Firm's ability to assess whether it had adequate and effective systems, controls and procedures to ensure complete and accurate regulatory reporting; and
- (b) The Risk Function had no formal second line oversight of RRT or Metro Bank's COREP reporting, which meant that the Firm had inadequate assurance as to whether its regulatory reporting was accurate or reliable. Prior to May 2018, the Firm's approach to identifying the RWA issue lacked coordination between its Risk and Finance functions.
- (2) In respect of COREP reporting issues, Metro Bank's escalation routes to the Executive Leadership Team, the Board and its committees regarding regulatory reporting lacked formality, were unclear and undocumented, and failed to operate effectively.

- (3) The Audit Committee, responsible for reviewing and monitoring management responses to the findings and recommendations of internal audits, provided limited detailed challenge regarding those management actions arising from the COREP audit that became overdue.

### Controls

3.9. Metro Bank's governance arrangements for regulatory returns were not supported by an effective and robust control framework. In particular:

- (1) Metro Bank failed to establish and implement effective controls in relation to its interpretation of relevant regulatory rules and guidance relevant to its COREP reporting:

- (a) Metro Bank failed to define, allocate or document clear roles and responsibilities for ensuring the completeness and accuracy of data used in regulatory reporting. There was no specific policy formally articulating roles and responsibilities for RWA calculation and reporting.

- (b) While the RRT was responsible for regulatory rule interpretation, Metro Bank failed to formally assign responsibility for systematically analysing new consultation papers or regulations to assess their relevance or impact on the Firm's regulatory reporting and how any changes should be implemented.

- (c) During the Relevant Period, Metro Bank failed to document sufficiently the rule interpretations it applied in the calculation of risk weightings for its lending portfolio. To the extent that rule interpretations were documented, they were embedded within spreadsheets and working papers, and so were not readily accessible. Furthermore, Metro Bank failed to establish and implement adequate and effective processes for reviewing and approving its regulatory interpretations, or the consistent application of those interpretations.

3.10. Metro Bank's approach to technical interpretations of COREP reporting requirements was insufficiently robust given the complexity of those decisions and the likely impact on reporting.

## Investment and Data

3.11. Metro Bank failed to allocate appropriate and adequate resources to enable it to comply with its COREP reporting obligations. In particular:

- (1) Metro Bank failed to invest adequately in, or instil a culture sufficiently focused on, systems and controls related to its regulatory reporting. Though human resourcing of the RRT increased throughout the Relevant Period, the Firm failed to satisfactorily address a lack of sufficient expertise and experience within RRT or to ensure that the size of RRT grew commensurate to the Firm's own growth. Rather, the Firm had a disproportionate focus on growth, to the detriment of regulatory compliance functions such as RRT and Risk Management.
- (2) Though Metro Bank sought to make process improvements throughout the Relevant Period, its RWA calculation process remained largely manual, reflecting the Firm's limited investment in systems during the Relevant Period, which heightened operational risk and created key-person dependencies on a small number of individuals familiar with spreadsheets that were not scalable. This was inadequate for an institution of Metro Bank's increasing scale.
- (3) Metro Bank's front-end data capture and systems did not allow it to capture all relevant information that the Firm needed (e.g., on counterparty and collateral type) to accurately classify exposures and calculate risk weights for its lending portfolio.
- (4) Relevant staff did not receive training on how data should be entered into the systems relevant to the Firm's COREP reporting, reflecting a lack of investment.

## **4. REASONS WHY THE PRA HAS TAKEN ACTION**

4.1. The PRA is responsible for the prudential regulation and supervision of banks, building societies, credit unions, insurers and major investment firms. The integrity of regulatory reporting is essential for the PRA to advance its primary objective to promote the safety and soundness of PRA-authorized firms.

4.2. The PRA expects all banks and building societies to submit complete, timely and accurate regulatory returns. The PRA also expects firms to have robust validation and governance processes that ensure regulatory reporting is consistently of a high standard. Where firms do not meet the PRA's expectations, there is an increased risk of material misstatements, which affects the PRA's advancement of its primary objective to promote the safety and soundness of PRA-authorized firms.

- 4.3. The PRA also has a secondary competition objective. When discharging its general functions in a way that advances its objectives, the PRA must so far as is reasonably possible act in a way which facilitates effective competition in the markets for services provided by PRA-authorized persons.
- 4.4. Challenger banks, such as Metro Bank, facilitate effective competition in the UK banking market, but to do so they must instil confidence with depositors. A material misstatement may erode confidence in a firm.
- 4.5. Accurate and timely prudential data supports going-concern supervision and is crucial in identifying, monitoring and managing periods when firms are under stress or recovering from such periods. The failure to provide accurate and timely regulatory data can indicate a range of weaknesses in a firm's ability to manage its business prudently. Firms that do not produce timely, complete and accurate data during periods of relative stability are less likely to do so under stress.
- 4.6. The PRA expectations in this regard are that firms should:
- (1) have in place robust governance and validation processes that ensure regulatory reporting is consistently of a high standard and submitted in a timely fashion. This should include:
    - (a) a clear organisational structure with well-defined, transparent and consistent lines of delegation and accountability regarding regulatory reporting; and
    - (b) clear escalation policies that are widely understood so that risks and crystallised issues can be managed and addressed at the appropriate level of seniority as soon as possible;
  - (2) make appropriate investment to ensure that both the integrity of the data and the ability to process it accurately are maintained;
  - (3) have in place adequate and effective systems and controls to ensure the correct application of relevant rule changes. Firms ought not to take undue comfort from their ongoing business-as-usual checking processes, particularly checks which look for unusual variances over time as certain errors (especially incomplete data and misinterpretation of requirements) may persist for a long time unnoticed because data has consistently been inaccurate and large variances across time do not occur; and

- (4) take reasonable care to organise their affairs responsibly and effectively, with adequate systems and controls in place to mitigate and prevent errors or misstatements in regulatory reporting or which might occur during the processing of regulatory data. These systems and controls should be commensurate to the size and complexity of the institution and designed to mitigate against potential risks to the integrity of the firm's regulatory reporting.
- 4.7. Metro Bank failed to ensure that key systems and controls supporting its regulatory reporting framework were designed, implemented and operated effectively and it failed to organise and control its compliance with the PRA's regulatory reporting requirements effectively.
- 4.8. Metro Bank's arrangements in this regard were deficient. It had the ability to plan for revenue growth supported by appropriate and scalable regulatory reporting arrangements and it failed to do so.
- 4.9. Following the RWA Adjustment, Metro Bank's Board instructed the Second Consultant to conduct a review of its regulatory reporting arrangements. Metro Bank accepted the Consultant's findings, and took a range of steps to remediate the issues identified.

## **5. SANCTION**

- 5.1. Taking into account the facts and matters in **Annex A** and the relevant factors set out in the PRA Penalty Policy, the PRA has concluded that Metro Bank's breaches of Fundamental Rule 2 and Fundamental Rule 6 justified the imposition of a financial penalty of £7,680,000. That penalty was reduced by 30% to £5,376,000 because Metro Bank settled the matter with the PRA during the Discount Stage.

## **6. ANNEXES/APPENDICES AND PROCEDURAL MATTERS**

- 6.1. The full particulars of the facts and matters relied on by the PRA in its decision-making process regarding the Firm can be found in **Annex A**. The Firm's breaches and failings are detailed in **Annex B** and the basis for the sanction the PRA imposed is set out in **Annex C**. The procedural matters set out in **Annex D** are important. The definitions

used in this Notice are set out in **Appendix 1** and the relevant statutory, regulatory and policy provisions are set out in **Appendix 2**.

**Oliver Dearie**

Head of Legal (Acting), Enforcement and Litigation Division  
for and on behalf of the PRA

## **ANNEX A – FACTS AND MATTERS RELIED UPON**

### **1. BACKGROUND**

#### **The Firm**

- 1.1 Metro Bank plc (“Metro Bank” or “the Firm”) is a UK bank, headquartered in London. It was established in 2010, and has been listed on the London Stock Exchange since 2016. The Firm is regulated by the PRA for prudential purposes and by the Financial Conduct Authority (“the FCA”) for conduct matters.
- 1.2 During the Relevant Period, Metro Bank was assigned as a Category 3 firm but as it grew it was recategorized as a Category 2 firm (from June 2018). As a Category 3 firm is a deposit-taker whose size, interconnectedness, complexity, and business type gave it the capacity to cause minor disruption to the UK financial system by failing or by carrying on its business in an unsafe manner, but where difficulties across a whole sector or subsector had the potential to generate disruption. A Category 2 firm is a significant deposit-taker whose size, interconnectedness, complexity, and business type give it the capacity to cause some disruption to the UK financial system (and through that to economic activity more widely) by failing, or by carrying on its business in an unsafe manner.
- 1.3 Metro Bank is a “challenger bank”, in the sense that it is a more recently created retail bank which seeks to compete directly with older, more established banks. It offers retail, business, commercial and private banking services in the UK. It has a network of 78 branches, serving 2.4 million customer accounts across the UK with a total loan book of £12.3 billion.
- 1.4 Throughout the period from 13 May 2016 to 23 January 2019 (“the Relevant Period”), Metro Bank’s strategy was to rapidly expand its footprint and scale of operations. This involved substantial year-on-year increases in its deposits from, and lending to, customers. In addition, the Firm’s total loan book grew significantly, from £5.9 billion in 2016 to £14.2 billion in 2018. The Firm achieved its first annual profit in 2017.

#### **The relevant regulatory framework**

- 1.5 Improving prudential standards relating to the capital adequacy of firms has been integral to the regulatory response to the global financial crisis. Capital requirements ensure that firms are managed prudently and hold sufficient funds to absorb losses in periods of stress and withstand adverse trading or economic conditions, thereby

facilitating safety and soundness. These rules are aimed at protecting firms, customers, the Financial Services Compensation Scheme, and the markets.

### Capital

1.6 Pursuant to the PRA's approach to banking supervision, the PRA determines a minimum regulatory capital level and buffers on top of this, as applicable, expressed in terms of the international standards developed by the Basel Committee on Banking Supervision ("the Basel Committee"), and collectively called Basel III.

1.7 The UK capital framework comprises four parts:

(1) Pillar 1 (requirements to provide protection against credit, market and operational risk, for which firms follow internationally agreed methods of calculation and calibration);

(2) Pillar 2A (PRA requirements reflecting estimates of risks either not addressed or only partially addressed by the international standards for Pillar 1);

(3) CRD IV buffers, as applicable (these comprise the capital conservation buffer and the countercyclical capital buffer, which are relevant to all firms); and

(4) The PRA buffer, as applicable (some firms may be subject to a PRA buffer which is an amount of capital that firms should hold in addition to their minimum level of regulatory capital (Pillar 1 plus Pillar 2A) to cover risks and elements of risk not covered elsewhere, and losses that may arise under a stress).

The UK capital framework is more fully described in "The Prudential Regulation Authority's approach to banking supervision, October 2018."<sup>2</sup>

### COREP reporting

1.8 Basel III sets out the criteria for instruments that a bank may include in its capital tiers and structures. A bank's capital may consist of Common Equity Tier 1 Capital ("CET 1"), Additional Tier 1 capital and Tier 2 capital. CET 1 is the highest quality capital and, for banks, consists mostly of ordinary shares and retained earnings/ reserves. The capital ratio measures a bank's capital against its assets. Because not all assets have the same risk, a bank's assets are weighted based on the risk that each asset presents. The higher the amount of Risk Weighted Assets ("RWA") that a firm has, the more capital it is required to hold.

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<sup>2</sup> <https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/approach/banking-approach-2018.pdf>.

- 1.9 Under the Capital Requirements Regulation (575/2013) (“CRR”) and in accordance with the PRA Rulebook, firms are required to submit periodic information to the PRA, including reports as part of the Common Reporting (“COREP”) framework; a reporting framework introduced to standardise the reporting of capital requirements and prudential regulatory information. These COREP reports include (amongst others) quarterly reporting on a firm’s current assessment of its RWA.

#### Standardised and Advanced Models

- 1.10 There are both standardised and internal ratings-based approaches for calculating credit risk RWA. In the UK, PRA approval is required before firms can adopt an internal ratings-based approach, including an advanced internal ratings-based approach (“AIRB”).
- 1.11 Under the standardised approach (“the SA”) that applied to Metro Bank throughout the Relevant Period, firms are required to use risk weights prescribed in the relevant rules to calculate their RWA. Article 112 of the CRR defines seventeen exposure classes for the purposes of risk weighting under the SA. Each exposure class is further divided into sub-categories of relevant exposures which, based on their features, are assigned different risk weights.
- 1.12 To calculate RWA under the SA, Metro Bank was required to take the value of its assets, assign them to the appropriate category depending on the type of the exposure and the type of counterparty, and apply to the assets in each of those categories the risk weighting prescribed in the PRA Rulebook to reflect the risks associated with assets of that category.

#### CLIP loans and PBTL loans

- 1.13 Whilst there are 17 exposure categories defined under Article 112 of the CRR, this Notice is concerned with certain exposures falling within the broader exposure class of “*exposures secured by mortgages on immovable property*” (Article 112(i) of the CRR); namely:
- (1) exposures fully and completely secured by mortgages on residential property (Article 125 of the CRR);
  - (2) exposures fully and completely secured by mortgages on commercial immovable property (Article 126 of the CRR), referred to in this Notice as “CLIP loans”; and

- (3) exposures secured by mortgages on immovable property, which includes mortgages secured on real estate that do not fall into Articles 125 or 126 (Article 124 of the CRR).
- 1.14 CLIP loans are loans that are fully and completely secured by mortgages on commercial immovable property. Under Article 126 of the CRR, the prescribed risk-weighting for such loans was 50%. However, this is potentially overridden by Article 124(2) of the CRR, which allows national regulators a discretion to impose stricter requirements where a 50% risk-weighting is inappropriate for its jurisdiction, having regard to the local property market. In implementing the CRR, the PRA exercised this discretion to impose a stricter regulatory capital treatment on CLIP loans. Under Rule 4.1 of the Credit Risk section of the PRA Rulebook, a 50% risk weight could only be assigned to CLIP loans “where annual average losses stemming from lending secured by mortgages on commercial property located in the UK did not exceed 0.5% of risk-weighted exposure amounts over a representative period”. When this test is not met, a 100% risk weight should be assigned under the fallback risk weighting in Article 124 of the CRR. For certain categories of loan including CLIP loans, the applicable risk weight percentage can be reduced by a further multiplier for loans made to small or medium sized entities where certain conditions are met on an ongoing basis (the “SME Supporting Factor”).
- 1.15 Metro Bank categorised certain loans as professional buy-to-let loans (referred to in this Notice as “PBTL loans”). PBTL loans are not defined, or treated as a separate class of exposure, under the CRR and so how they should be allocated under CRR articles is dependent on how a firm has defined them.
- 1.16 The following exposures classes may be relevant to Metro Bank’s treatment of PBTL loans: Exposures fully and completely secured by mortgages on residential property, that are subject to a risk weighting of 35% (under article 125 of the CRR); CLIP Loans that are subject to a risk weighting of 100% (as described at paragraph 1.14 above); and exposures secured by mortgages on immovable property, which includes mortgages secured on real estate that do not fall into articles 125 or 126, that are subject to a risk weighting of 100% (under article 124 of the CRR).
- 1.17 It should be noted that Metro Bank also categorised certain secured loans as commercial real estate loans (“CRE loans”). However, Metro Bank differentiated these from its CLIP and PBTL loans. Metro Bank defined CRE loans as “*exposure to non-individual customers when the exposure is used to finance the investment or development of real estate (including offices, retail, multifamily residential buildings,*

*industrial/warehouse units, hotels and land) and the income generated by the real estate is lease or rental payments from AN Others or the proceeds from the sale of the real estate to AN Other.”*

### **Metro Bank’s RWA Adjustment**

1.18 Prior to January 2019, Metro Bank:

(a) was risk weighting its CLIP loans at 50% under Article 126 of the CRR as it had failed to identify that the PRA had exercised its discretion in the way set out at paragraph 1.14 above; and

(b) assessed that certain of its PBTL loans should be treated as: (i) exposures fully and completely secured by mortgages on residential property, with a risk weighting of 35% (where the PBTL loan is secured on residential property and the relevant conditions under article 125 of the CRR are met); (ii) CLIP loans with a risk weighting of 50% under Article 126 of the CRR; or (iii) exposures secured by mortgages on immovable property within Article 124 of the CRR where not captured within articles 125 or 126, and therefore subject to a risk weighting of 100%; and that the SME Supporting Factor was not available to PBTL Loans;

whereas Metro Bank should have in fact been applying a 100% risk weighting to CLIP loans and to certain PBTL loans. The identification of these (and other) errors led to Metro Bank making an adjustment to its RWA assessment for December 2018.

1.19 On 23 January 2019, Metro Bank announced an increase in its RWA for Q4 2018 of approximately £900 million as against the RWA figures included in its COREP reporting for Q3 2018 and in the Bank’s Q3 trading update on 24 October (“the RWA Adjustment”). This adjustment was driven by:

(1) an increase of £563 million in RWA due to Metro Bank adjusting the risk weighting of CLIP loans from 50% to 100%. Prior to this point, Metro Bank was not applying a risk weight of 100% to all of its CLIP loans, as required by the PRA;

(2) an increase of £312 million in RWA due to the Bank adjusting the risk weighting of certain PBTL loans from 35% to 100%. Prior to 23 January 2019, Metro Bank applied a 35% risk weight to certain PBTL loans where it should have been applying a 100% risk weight as the criteria under Article 125 of the CRR had not been met and/or the collateral securing the loan was incorrectly categorised as residential property; and

- (3) an increase of approximately £25 million due to a number of less material adjustments arising from the classification of certain exposures as being exposures associated with particularly high risk (speculative immovable property financing); assigning conversion factors to off-balance sheet items; classification of exposures as exposures in default; and classification and treatment of exposures to small or medium enterprises.

## 2. METRO BANK'S REGULATORY REPORTING ARRANGEMENTS

### The regulatory reporting process

- 2.1. During the Relevant Period, the Regulatory Reporting Team ("RRT") within Metro Bank's Finance division was responsible for the Firm's regulatory reporting. In particular, RRT was responsible for regulatory rule interpretation and the production and submission of regulatory returns to the PRA, including COREP reports.
- 2.2. Metro Bank did not have a specific documented policy formally articulating roles and responsibilities for RWA calculation and reporting. In practice, RRT relied on various other functions within Metro Bank for inputs into calculating the Firm's RWA and producing regulatory reports, including: (i) Business functions; (ii) IT; (iii) Data Governance, and (iv) Risk as described below.
- 2.3. The process by which Metro Bank prepared and submitted COREP reports to the PRA during the Relevant Period can be summarised as follows:
  - (1) **Data input:** The Firm's relationship managers ("RMs") across various business areas (including Commercial, Operations and Retail) populated loan information into Metro Bank's data collection platforms when loans were first originated. This was combined with data drawn from other sources (such as from Risk in relation to credit risk/provisions) to form the source data for COREP reporting. Metro Bank did not have a documented description of roles and responsibilities for data used in regulatory reporting, for example to set out the responsibilities of upstream owners and providers of data to the regulatory reporting team with regard to completeness and accuracy. In addition, front-end data capture did not allow Metro Bank to capture all the information needed to enable exposures to be accurately classified (e.g. on counterparty and collateral type), and RMs had not received training on how data would be used for regulatory reporting (which was necessary for understanding how data should be entered into the systems).

- (2) **Data processing, storage and feed generation:** RRT obtained data from a range of systems to use for regulatory reporting; some was obtained from source systems and some was provided by the Firm's Data Governance team. The IT team managed all source systems relevant to regulatory reporting and had oversight of third-party systems and software. IT managed all IT data feeds and was responsible for ensuring the raw data was correctly processed and stored. The Data Governance team oversaw Metro Bank's policies and controls for ensuring the quality of data captured (for instance, through mandatory fields and formats) but did not stipulate the data points to be captured. Finance had a dedicated IT resource which assisted in resolving issues with data feeds or systems. However, Metro Bank's systems did not include the necessary fields to enable the Firm to capture all information relevant to determining its RWA.
- (3) **Regulatory report generation and submission:** RRT was responsible for using the above data to produce and submit Metro Bank's regulatory reports to the PRA. In calculating Metro Bank's RWA, significant manual intervention was required as opposed to RRT being able to rely on the data produced by the Firm's systems.
- (4) **Regulatory rule interpretation:** During the Relevant Period, RRT was responsible for regulatory rule interpretation. From May 2018, although it had no formally defined role with regards to regulatory rule interpretation, Risk provided input and collaborated with RRT in this regard. Prior to Q4 of 2018, the Firm did not document in a single place rule interpretations and applications in relation to RWA calculation. To the extent the Firm did document such rule interpretations, these were embedded within spreadsheets and working papers, and so were not readily accessible.
- (a) For much of the Relevant Period, there was a lack of clearly defined escalation processes through which interpretations of regulatory requirements were reviewed or approved. Metro Bank had not formally assigned responsibility for systematically analysing new consultation papers or regulations to assess their relevance or impact on the Bank and how best to implement them. Roles and responsibilities for implementation of regulations and for review, challenge and oversight of RWA and regulatory reporting were not clearly assigned outside of the Finance function. Furthermore, for much of the Relevant Period there was no review or approval process for regulatory interpretations that was consistently applied.

However, from May 2018, Risk provided input and collaborated with the RRT on regulatory rule interpretation.

- (5) **Sign off:** Quarterly sign off meetings took place between Metro Bank's Finance and RRT staff to finalise and approve COREP reports. Monthly reports were also provided to the Board on movements in RWA and capital.

### **Governance and Oversight**

- 2.4. During the Relevant Period, Metro Bank's Board set the Firm's strategy for management, governance, controls, risk management, direction and performance. Various Board committees assisted the Board in fulfilling its oversight role. Metro Bank's executive leadership committees were responsible for implementing the strategy set by the Board, consistent with appetite, and for managing the different aspects of the Firm's business. The executive leadership committees also recommended risk strategy changes to the Board.
- 2.5. The following committees and governance fora had, amongst other responsibilities, some involvement in Metro Bank's regulatory reporting framework:
  - (1) **The Board** had overall responsibility for Metro Bank's governance and oversight of financial regulatory reporting. The Board received a monthly summary of key financial metrics (including RWA) from RRT.
  - (2) **The Audit Committee** (a Board committee) considered the findings of any internal audits undertaken (including those in relation to the Firm's regulatory reporting processes) and formally reviewed and approved financial statements and reports in light of those findings.
  - (3) **The Risk Oversight Committee** (a Board committee) was responsible for the Internal Capital Adequacy Assessment Process ("ICAAP"), Internal Liquidity Adequacy Assessment Process ("ILAAP"), and Pillar 3 disclosures and recommending risk appetite statements to the Board, and ensuring that financial statement information met the relevant reporting standards.
  - (4) **The Credit Risk Policy and Appetite Committee** ("CRPAC") (an Executive Committee) was the "designated committee" for the purposes of Metro Bank's AIRB Application (as required under the CRR and relevant PRA guidance) and Credit Risk Model Framework. After May 2018, CRPAC was involved in discussion and assessment of material rule interpretations that led to changes to

Metro Bank's risk weightings. However, prior to this, there was no independent assessment of RRT's rule interpretations.

- (5) **The Asset and Liability Committee** (an Executive Committee) received reports on RWA and outputs for regulatory returns but played no formal role in COREP reporting and had no interaction with RRT.
- (6) **The Executive Risk Committee** (an Executive Committee) considered enterprise-wide risks but had no formal role in or responsibility for regulatory reporting.

2.6. Though the Firm's RWA was reported to several Board and Executive committees, no committee had formal oversight of RWA calculation and COREP reporting, and escalation routes were unclear.

### **Risk Management**

2.7. Metro Bank operated a three lines of defence model for risk management under the oversight of the Board:

- (1) **First line of defence:** operational management of business areas (including support functions) were responsible for owning and managing the risks which existed in their business area. Metro Bank relied on a number of systems and processes to generate and collect the data required to prepare COREP Returns. However, there was no automated process which validated or checked the data. Any such validation or checking was manual in nature and relied on the use of many different data sources and manipulation of spreadsheets, which raised operational risk and created key person dependencies on the small number of individuals familiar with the spreadsheets.
- (2) **Second line of defence:** Metro Bank's Risk function supported and challenged the first line of defence, provided formal monitoring, advice and assurance to the business area that owned the process or the policy. Risk's role with regard to RWA calculation, rule interpretation, capital adequacy and regulatory reporting was informal and undefined. Prior to May 2018, Risk did not have any formal role or responsibilities in relation to Metro Bank's COREP reporting and provided no formal second line oversight of COREP reporting. From May 2018, as a result of the AIRB Application, the Risk team collaborated with Finance and RRT to check that interpretations and inputs were correct, offering guidance to stakeholders on

what regulatory policy dictated (such as the correct classification of a certain product).

- (3) **Third line of defence:** Internal Audit provided assurance through reviews and reports of the Bank's systems and controls that were produced for the Audit Committee throughout the Relevant Period. In discharging its responsibilities, Internal Audit interacted with RRT and Finance. Internal Audit also conducted individual spot checks on the regulatory reporting process and reported its findings to the Audit Committee. However, since Metro Bank's authorisation in 2010, no review of COREP reporting had taken place until the COREP audit of June 2017. As described in more detail below, Internal Audit's COREP audit report in June 2017 did not identify the Firm's incorrect interpretation of the PRA requirements on the risk weighting of CLIP loans.

### **Resourcing of the regulatory reporting process and control framework**

- 2.8. In January 2017, RRT comprised four individuals, with only one permanent member of staff (who was relatively junior) and three contractors, led by a newly appointed interim Head of RRT.
- 2.9. In April 2017, RRT reported internally on a list of key issues for RRT. The list included the need to identify CRE loans and noted that these should be risk weighted at 100% but that it was not possible to distinguish these loans with the data available on Metro Bank's systems. RRT also raised that there was insufficient resource in RRT to work on all of the issues on the list at the same time. Manual processes and a lack of expertise in interpreting the rules relating to commercial loan classification compounded this lack of resource.
- 2.10. In the first half of 2017, RRT had no budget for additional contractors or permanent hires, nor for external experts. RRT was encouraged to seek support from staff in other teams within Metro Bank. RRT also sought informal "free" advice from the Second Consultant on the correct risk weighting of commercial loans.
- 2.11. In response to the report of Internal Audit's review of COREP reporting in June 2017 (the "COREP audit report"), RRT was expanded in numbers, but there was still insufficient resource devoted to the team. In September 2018, RRT outlined its main priorities for the coming weeks and months. These priorities included staffing RRT and the need to appoint external consultants. By this stage, RRT had expanded to six

people, but there was considerable stretch in the team, with members of the team on temporary consultancy contracts.

2.12. In October 2018, the Second Consultant confirmed that RRT continued to be under-resourced and observed “[t]here are currently insufficient resources within the regulatory reporting team to support regular ongoing review of the RWA calculations and manual adjustments made through the report production process”.

2.13. The lack of resource in RRT and its reliance on consultants and temporary contractors was symptomatic of a wider lack of resource, including within the Risk function. In its report delivered to the Metro Bank Board in June 2019, the Second Consultant observed that:

*“Management interviewed confirmed that, historically, they had not undertaken an overall assessment of the skills, competencies and level of resource required in the Risk function based on the Bank’s financial plan, business strategy, risk profile and risk strategy. This in itself was due to resource constraints.”*

2.14. In the same report, the Second Consultant commented, *“there is also some concern with a potential over-reliance on short-term temporary resource”*.

2.15. RRT has since grown to a team of more than twelve individuals.

### **3. THE RWA ISSUE**

#### **2016 PSM letter**

3.1. The PRA holds an annual firm-specific meeting, known as a Periodic Summary Meeting (“PSM”) to discuss internally the key risks the firm poses to the PRA’s objectives, as well as the actions the PRA expects the firm to take in light of those key risks. The PRA summarises its views in a letter subsequently issued to the firm.

3.2. Following the 2016 PSM for Metro Bank, the PRA wrote to the Firm in May 2016 noting its very high resubmission rate for certain regulatory returns and requesting an action plan to resolve the issue. These concerns did not materially impact Metro Bank’s capital position and were not understood within Metro Bank’s Finance function to relate to its approach to risk weights or to its COREP reporting.

3.3. In response, Metro Bank sought to resolve the PRA’s concerns through the implementation of a new regulatory reporting system, the strengthening of RRT and

the implementation of additional controls. However, as set out above, these steps did not adequately address the issues concerning the regulatory reporting control environment and adequacy of RRT resources.

### **Internal Audit of COREP reporting**

#### Scope

- 3.4. In September 2016, the PRA informed Metro Bank that it had selected the Firm to participate in a PRA thematic project focusing on COREP reporting. The PRA requested that the Firm's Internal Audit function ("Internal Audit") conduct a review of its COREP reporting ("the COREP audit"); in particular, in order to:
- (1) review and assess the effectiveness of Metro Bank's procedures and controls to produce COREP reports;
  - (2) assess the completion of a sample of submitted COREP returns; and
  - (3) report on whether the returns were completed in accordance with the definitions, calculations and methods defined in the CRR and guidance from the EBA.
- 3.5. Internal Audit began fieldwork for this audit in January 2017. Separately, Metro Bank also began its project to seek the PRA's permission to use the AIRB approach to calculate risk weightings for residential mortgages in the first instance and other loan types in later phases ("the AIRB Application").

#### The COREP audit report

- 3.6. Internal Audit circulated a draft report in March 2017, followed by the final report in June 2017 ("the COREP audit report"). The COREP audit report was graded "3" out of 4 (with a grade 4 indicating material findings), which meant "*specific control weaknesses were noted. Controls evaluated are unlikely to provide reasonable assurance that risks are being managed and objectives should be met.*"
- 3.7. The COREP audit report identified a number of errors, including the incorrect risk weighting of certain CRE loans between 25% and 50% instead of at 100%. This resulted in Metro Bank understating its capital requirement by approximately £12m in each of the June 2016 and September 2016 COREP reports it submitted to the PRA. The other errors identified did not have a material impact on Metro Bank's total RWA figures or capital requirement.

- 3.8. The COREP audit report identified “*a lack of documented policies and procedures*”, “*a lack of skilled resources to interpret the rules*” and “*upstream data inaccuracies*” as being the main causes of the issues, and also identified a lack of review or oversight of COREP returns. As for the Firm’s incorrect risk weighting of certain CRE loans, the COREP audit report concluded that the root cause was that Metro Bank’s systems did not capture the purpose of the loan to enable it to classify a loan as being a “CRE loan”. It added that, before the COREP audit, Finance had already identified the need for significant improvement and it cited new recruits to the Finance and RRT functions as seeking to address this.
- 3.9. Whilst the COREP audit report identified incorrect risk weighting of certain of the Firm’s CRE loans, it did not identify the different and distinct RWA errors subsequently identified that led to the RWA Adjustment in January 2019. In particular, the COREP audit report did not identify the broader issues that Metro Bank was incorrectly risk weighting CLIP loans and PBTL loans, which was to have a larger impact on its RWA calculation. Rather, the COREP audit report incorrectly stated that Metro Bank had been “*prudent*” in risk weighting CLIP loans at 50% whereas Metro Bank should have in fact risk weighted CLIP loans at 100%. Metro Bank continued to submit COREP returns to the PRA on an inaccurate basis. Metro Bank’s last inaccurate COREP return was its quarterly report covering the three months to 30 September 2018.

#### Follow-up actions to the COREP audit report

- 3.10. Finance senior individuals agreed actions required to address the issues identified by the COREP audit report and presented the findings to the Board and the Firm’s Audit Committee later in June 2017. Finance senior individuals confirmed to the Audit Committee that ensuring the accuracy and timeliness of COREP reporting was a priority and that recent personnel changes and improvements in data and controls would lead to a “*rapid and significant improvement in delivery*”.
- 3.11. Metro Bank provided the PRA with the COREP audit report and the relevant Audit Committee minutes in July 2017. Progress against actions was reported to and overseen by the Audit Committee.
- 3.12. To remedy the Firm’s incorrect risk weighting of CRE loans, RRT proposed:
- (1) in the short term, to estimate the Firm’s overall CRE exposures and adjust the COREP returns accordingly; and

- (2) by December 2017, to implement a new field in the Firm's systems in which staff would classify each loan and identify those that were CRE loans.
- 3.13. For the short-term action, RRT made adjustments to the COREP return, which were reflected in Metro Bank's June 2017 COREP return submitted in August 2017. For the longer-term solution, individuals within Finance and Risk arranged for the addition of a new drop-down field in the Firm's customer relationship management system.
- 3.14. For existing loans, relationship managers conducted an exercise of classifying all loans in accordance with the new definitions, including CRE loans, and stored the resulting data in a separate system. The exercise took several iterations over a number of months and was time-consuming due to the manual processes involved.
- 3.15. Metro Bank reflected the adjusted RWA in: (i) its December 2017 COREP report submitted in February 2018; (ii) its year-end financial reporting published in February 2018; and (iii) its Pillar 3 disclosures published in June 2018.
- 3.16. In March 2018, the PRA requested confirmation from Metro Bank that work to remediate the COREP audit findings was underway, which the Firm provided. The PRA asked to be updated on total CRE exposure when the portfolio review was complete.
- 3.17. Some overdue management actions relating to COREP remained outstanding for over six months until confirmation of final closure of these actions in Q1/Q2 of 2018.

### **Developing concerns and engagement of the First Consultant**

- 3.18. Between February and April 2018, the Firm's exercise to identify CRE exposures – and separately its work on the Bank's AIRB Application – led certain individuals within Finance and Risk (below senior manager level) to explore concerns that there may be issues with the Firm's risk weighting of other portfolios of commercial loans that had not been identified or remediated as a result of the COREP audit, including in respect of CLIP loans. In addition, certain individuals within these functions also began to have concerns about whether the Firm was correct in risk weighting all BTL loans at 35%, without considering if the requisite conditions were met in relation to its PBTL loan portfolio.<sup>3</sup> The issue and its potential impact was not escalated to Metro Bank's senior management at this time.

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<sup>3</sup> These conditions are set out in Article 125 CRR and PRA policy statements and broadly require: (i) that the property is residential in nature; (ii) the value of the property is not materially dependent on the creditworthiness of the borrower; (iii) certain requirements regarding mortgage enforceability, independent valuation, monitoring property values, lending policies and insurance are met; and (iv) the part of the loan to which the 35% risk weight is assigned amounts to no more than 80% of the property's value.

- 3.19. To address these concerns, in April 2018 Metro Bank engaged an external consultancy firm (the “First Consultant”) to prepare flow diagrams setting out a structured series of questions (referred to as “decision trees”) to enable the Firm to work out how to classify and risk weight loans correctly for the purposes of (among other things) calculating RWA under both the SA and the AIRB approach.
- 3.20. The First Consultant presented draft decision trees in May 2018, which were finalised in August 2018. By 31 May 2018, certain individuals in Metro Bank’s Finance and Risk functions had identified from their work with the First Consultant that the Firm’s risk weighting classifications for all CLIP loans were incorrect and should have a risk weighting of 100%. In addition, concerns were raised by certain individuals in Metro Bank’s Finance and Risk functions as to whether Metro Bank was correct in risk weighting all PBTL loans at 35%, without considering if the requisite conditions were met in relation to its PBTL loan portfolio. The details of the nature of the issue were not escalated to senior management at this time.
- 3.21. During the period May 2018 to August 2018, members of the Firm’s Finance, Risk and Commercial Lending functions continued to discuss the correct approach to risk weighting two portfolios of commercial loans, CLIP loans and PBTL loans.
- 3.22. In July 2018, the PRA raised questions with Metro Bank regarding the Firm’s commercial loans risk weights and Metro Bank explained that these were under review but may change as a result of the First Consultant’s decision trees exercise.
- 3.23. The PRA, in a separate exchange in July 2018, informed Metro Bank that the application of a 44% average risk weighting to the “*CRE Other*” loan book appeared low on the basis that it included unsecured commercial loans and commercial investment loans; and the March 2018 COREP return recorded £1.1 billion of exposures to CLIP loans at 50% risk weight. The PRA also informed Metro Bank that questions had been raised internally at the PRA in this regard. In its response to the PRA, Metro Bank stated that both approaches were under review as part of its ongoing asset classification and risk weighting work but that, as a result of that work, Metro Bank now believed both risk weightings to be inaccurate.
- 3.24. Individuals in Finance, Risk and Commercial Lending continued to discuss the correct approach to risk weighting commercial loans and PBTL throughout August 2018. This included not only the correct regulatory interpretation based on the First Consultant’s Decision Trees, but also the challenges posed by issues with the underlying data in

Metro Bank's systems. For instance, to correctly risk weight BTL exposures, the Firm required data on the underlying property's use class, which was not held in its systems.

- 3.25. On 24 August 2018, a member of the Firm's Credit Risk team informed members of Metro Bank's senior management that the Firm's risk weighting of CLIP and PBTL loans was substantially incorrect and that, based in part on a sampling exercise, they estimated that correcting the risk weighting would result in an increase of approximately £900 million in RWA (representing an approximately £70 million increase in Tier 1 capital). This estimate consisted of increases of approximately £640 million and £269 million in respect of CLIP loans and PBTL loans respectively. This was the first occasion on which the potential scale and impact of the RWA errors were escalated to the Firm's senior management.
- 3.26. The causes of this increase were noted as being:

*"Assets backed by commercial real-estate are currently in Metro allocated a standardised risk weight of 50%. This is based on a simplistic interpretation of the European CRR rules. Following detailed PRA statements and reviewing BIPRU confirms that the PRA have used their permitted powers of derogation to ensure that relevant assets in the UK backed by commercial Real Estate should receive a 100% RW. This interpretation has been confirmed by a full [First Consultant] review."*

*"PBTL assets are backed by residential properties and currently receive a 35% risk weight. Stratified random sampling however reveals that circa 37% of the balances in the book are actually secured on Multi-Family Dwellings (many leases on a single property), Houses in Multiple Occupation or Student accommodation. These should have received a 100% risk weight."*

#### **2018 PSM letter**

- 3.27. On 6 September 2018, the PRA met with Metro Bank and raised concerns regarding the Firm's miscalculation of risk weightings for certain types of commercial loans. In response, Metro Bank stated that the miscalculation was "*clearly an error on our part and was being fixed*".
- 3.28. The PRA's concerns raised at this meeting were reflected in its PSM letter to Metro Bank of 10 September 2018, which noted that the Bank was remediating the classification of commercial risk weights and required (among other things) that the Firm submit the results of its commercial risk weighting exercise to the PRA once

complete together with an attestation from a member of the Firm's senior management confirming the accuracy of the Firm's regulatory reporting.

- 3.29. The PRA's letter and the likely need for adjustments to Metro Bank's risk weightings for CLIP loans and PBTL exposures were discussed at the Board, Audit Committee and Risk Oversight Committee meetings in September and October 2018.

#### **Review by the Second Consultant**

- 3.30. On 21 September 2018, Metro Bank asked another external consultant ("the Second Consultant") to support a thorough review of the Firm's risk weighting of commercial lending and enable the attestation to be provided to the PRA.
- 3.31. In early October, senior management at Metro Bank informed the PRA that, pending the outcome of the Second Consultant's review, the Firm's COREP reporting would remain unaltered. The PRA agreed to this approach.
- 3.32. On 16 October 2018, Metro Bank formally engaged the Second Consultant to review and remediate the Firm's policies, procedures and controls in relation to the calculation of RWA and COREP reporting. After an initial two-week review, the Second Consultant advised Metro Bank that it would take until at least December 2018 to provide an accurate RWA calculation, and longer to remediate the issues at the various stages of the COREP reporting process.
- 3.33. On 1 November 2018, the Second Consultant, having performed the initial two-week review of the RWA calculation and COREP reporting process, concluded that "*[t]he most significant mis-statement in the RWA calculation is due to the incorrect risk weighting of commercial property at 50% rather than 100%. Impact c. £600 RWA [...] [C]urrently it is virtually impossible to evidence the integrity of the RWA calculation or the COREP reports. This is because there are multiple gaps in the controls framework at every stage of the process, from data sourcing through to report generation.*"
- 3.34. In particular, the Second Consultant also identified that there was no central document setting out Metro Bank's interpretation and application of regulatory requirements, with interpretation and application embedded within various spreadsheets, emails and presentations. The presentation observed that "*the diverse nature of these documents means it would be very difficult to demonstrate governance over this crucial area*".
- 3.35. Throughout October to December 2018, the Second Consultant reviewed Metro Bank's systems, controls and policies in relation to RWA calculation and COREP

reporting as against industry standards. The Second Consultant and Metro Bank also continued to review the loans identified as PBTL in the Firm's systems in order to determine the correct risk weightings. As these reviews continued, the Firm considered how the anticipated adjustments to the risk weightings of CLIP loans and PBTL loans could affect its future business plans.

- 3.36. On 20 December 2018, the Second Consultant informed Metro Bank of the result of its exercise, as follows: *"It is estimated that, in aggregate, the issues identified in the RWA calculation will increase RWA by £0.9-1.0bn, and an increase in capital requirements of c. £100m, at a target capital ratio of 12.5%."* In addition to the need for Metro Bank to adjust the risk weighting of CLIP loans, the Second Consultant's review confirmed that adjustment to the risk weighting of PBTL loans was required, as well as several other less significant RWA adjustments. The review identified a number of deficiencies in Metro Bank's processes and procedures, systems and controls in place to assess and report on RWA, including deficiencies in the data gathered, manual intervention required, lack of documentation and lack of effective oversight of the process.

#### **The RWA Adjustment**

- 3.37. During January 2019, Metro Bank engaged with the PRA regarding the results of the Second Consultant's review and the Firm's next steps in response. On 22 January 2019, the PRA confirmed that the adjustments to CLIP and PBTL risk weightings needed to be made immediately and in full. On 23 January 2019, Metro Bank issued its Full Year 2018 Results Preview and Trading Update.
- 3.38. The announcement itself did not give specific details regarding the re-categorisation and RWA Adjustment. Instead it provided a revised approximation of £8.9 billion for its RWA:

*"Risk weighted assets at full year are expected to be approximately £8.9bn with the increase driven by both net loan growth and an adjustment in the risk weighting of certain commercial loans secured on property and certain specialist BTL loans to large portfolio landlords."*

- 3.39. The RWA Adjustment was driven by:
- (1) an increase of £563 million in RWA due to Metro Bank adjusting the risk weighting of CLIP loans from 50% to 100%. Prior to this point, Metro Bank was not applying a risk weight of 100% to all of its CLIP loans, as required by the PRA;

- (2) an increase of £312 million in RWA due to Metro Bank adjusting the risk weighting of certain PBTL loans from 35% to 100%. Prior to December 2018, Metro Bank applied a 35% risk weight to certain PBTL loans where it should have been applying a 100% risk weight; and
  - (3) an increase of approximately £25 million due to a number of less material adjustments.
- 3.40. On 23 January 2019, Metro Bank announced to the market that it was making an adjustment to its assessment of its risk weighted assets (“RWA”) for December 2018 of approximately £900 million (“the RWA Adjustment”). The Firm’s announcement also stated that its profits for 2018 were below expectations due to tougher trading. The effects of the RWA adjustment combined with other factors to contribute to a risk to the PRA’s advancement of its primary objective to promote the safety and soundness of PRA authorised firms.
- 3.41. On 24 January 2019, Metro Bank shared with the PRA a regulatory interpretation document prepared by the Second Consultant explaining the PBTL treatment adopted.

#### **Remediation exercise**

- 3.42. In light of the findings of the Second Consultant’s review, Metro Bank undertook a programme to remediate the RWA errors, and identify and address root causes. In May 2019, Metro Bank shared with the PRA the findings and recommendations arising from this review. The Firm’s remediation exercise continued throughout 2019 and drew on the support of external consultants in order to deliver enhancements to the Firm’s governance and control environment (including its policies, procedures, resourcing, roles and responsibilities, data quality, culture, reporting, systems and record-keeping). This remediation exercise concluded with an external assurance review of Metro Bank’s RWA process, which included a line-by-line review of the Firm’s loan book to ensure the accuracy of the RWA figures reported by Metro Bank. Metro Bank calculates the total cost of its remediation exercise to have been over £15m.
- 3.43. The PRA and FCA also requested that Metro Bank undertake a review of its Enterprise Risk Management Framework (“RMF”). The RMF & Risk Culture review was carried out by the Second Consultant, with the findings and recommendations shared with the PRA in June 2019. This review informed enhancements to governance and risk management that were completed as part of Metro Bank’s remediation exercise in 2019.

3.44. The Second Consultant found that Metro Bank's Risk Management Framework was underdeveloped in a number of key areas, particularly given the rapid growth of the business, both historically and planned. In total, 43 recommendations to improve the RMF were made by the Second Consultant. These included:

- (1) the need to enhance risk governance arrangements and clarify responsibilities across first and second line of defence functions;
- (2) an immature approach to risk appetite, hindered by the absence of a documented, Board- approved business strategy and risk strategy; and
- (3) shortfalls in risk policies, the monitoring of compliance with risk policies, risk reporting, risk resourcing, risk culture and awareness, and documentation.

## **ANNEX B: BREACHES AND FAILINGS**

- 1.1. During the Relevant Period, as a result of the facts and matters set out at Annex A to this Notice, Metro Bank breached relevant requirements of the PRA Rulebook – Fundamental Rules 2 and 6.
  - (1) Fundamental Rule 2 requires that a firm must conduct its business with due care, skill and diligence.
  - (2) Fundamental Rule 6 requires that a firm must organise its affairs responsibly and effectively.
- 1.2. These rules are included at Appendix 2.
- 1.3. Metro Bank pursued a rapid growth and expansion plan and during the Relevant Period increased its number of high-street branches and customers, growing core deposits and lending. However, Metro Bank failed to ensure the commensurate development of and investment in governance arrangements and systems and controls relating to its COREP reporting, which it failed to design, implement or operate effectively in a number of respects.
- 1.4. As a result, Metro Bank's arrangements in respect of regulatory reporting to the PRA were inadequate to ensure accurate and reliable reporting for an organisation of Metro Bank's size, such that its COREP reporting to the PRA was inaccurate. As set out above, the Firm's application of risk weightings to certain commercial loans resulted in the RWA Adjustment.

### **PRA expectations**

- 1.5. The integrity of regulatory reporting is essential for the PRA to advance its primary objective to promote the safety and soundness of PRA-authorized firms.
- 1.6. The PRA expects all banks and building societies to submit complete, timely and accurate regulatory returns. The PRA also expects firms to have robust validation and governance processes that ensure regulatory reporting is consistently of a high standard. Where firms do not meet the PRA's expectations, there is an increased risk of material misstatements, which affects the PRA's advancement of its primary objective to promote the safety and soundness of PRA-authorized firms.

- 1.7. The PRA also has a secondary competition objective. When discharging its general functions in a way that advances its objectives, the PRA must so far as is reasonably possible act in a way which facilitates effective competition in the markets for services provided by PRA-authorized persons.
- 1.8. Challenger banks, such as Metro Bank, facilitate effective competition in the UK banking market, but to do so they must instil confidence with depositors. A material misstatement may erode confidence in a firm.
- 1.9. Accurate and timely prudential data supports going-concern supervision and is crucial in identifying, monitoring and managing periods when firms are under stress or recovering from such periods. The failure to provide accurate and timely regulatory data can indicate a range of weaknesses in a firm's ability to manage its business prudently. Firms that do not produce timely, complete and accurate data during periods of relative stability are less likely to do so under stress.
- 1.10. The PRA expectations in this regard are that firms should:
  - (1) have in place robust governance and validation processes that ensure regulatory reporting is consistently of a high standard and submitted in a timely fashion. This should include:
    - (a) a clear organisational structure with well-defined, transparent and consistent lines of delegation and accountability regarding regulatory reporting; and
    - (b) clear escalation policies that are widely understood so that risks and crystallised issues can be managed and addressed at the appropriate level of seniority as soon as possible;
  - (2) make appropriate investment to ensure that both the integrity of the data and the ability to process it accurately are maintained;
  - (3) have in place adequate and effective systems and controls to ensure the correct application of relevant rule changes. Firms ought not to take undue comfort from their ongoing business-as-usual checking processes, particularly checks which look for unusual variances over time as certain errors (especially incomplete data and misinterpretation of requirements) may persist for a long time unnoticed because data has consistently been inaccurate and large variances across time do not occur; and

- (4) take reasonable care to organise their affairs responsibly and effectively, with adequate systems and controls in place to mitigate and prevent errors or misstatements in regulatory reporting or which might occur during the processing of regulatory data. These systems and controls should be commensurate to the size and complexity of the institution and designed to mitigate against potential risks to the integrity of the firm's regulatory reporting.
- 1.11. In addition, firms should implement an effective controls framework to identify errors or misstatements in underlying data or which might occur during the processing of such data. A firm's regulatory reporting control framework should be commensurate to the size and complexity of the institution and designed to mitigate against potential risks to the quality of the firm's regulatory reporting. The controls framework should also include appropriate on-going validation to ensure that the firm is able to submit accurate returns on a continuing basis.
- 1.12. The PRA also expects a firm to have effective systems and controls in place to ensure the correct and prompt application of relevant rule changes that affect regulatory reporting. Where the application of regulatory reporting rules requires an element of interpretation or judgment, firms should have a clear and robust governance process in place to ensure that such decisions are challenged, validated and documented appropriately.
- 1.13. Firms should clearly identify and document individual responsibility and accountability for all aspects of their regulatory reporting arrangements. Firms must also make sure that individuals carrying out such roles are familiar with their duties and responsibilities so that they can exercise effective oversight of the firm's regulatory reporting framework.
- 1.14. As part of its supervisory approach, the PRA regularly requests that firms' internal audit functions conduct reviews that are either specific to the firm or on areas of thematic interest to the PRA, to provide firms and the PRA with assurance. Firms should take sufficient care to ensure that internal audit reviews are conducted with appropriate technical expertise and provide robust assessments of adherence to and the effectiveness of a firm's internal systems and controls, procedures and policies.

## **Fundamental Rule 2**

- 1.15. Fundamental Rule 2 requires a firm to conduct its business with due skill, care and diligence.

- 1.16. How a firm manages compliance with the PRA's regulatory requirements is an integral part of the PRA's assessment of a firm's safety and soundness. The PRA therefore expects firms to exercise due skill, care and diligence in implementing and operating its controls and in responding to concerns raised by the PRA.
- 1.17. During the Relevant Period, Metro Bank breached PRA Fundamental Rule 2 because it failed to take sufficient care to ensure that it complied with its reporting obligations to make accurate COREP reports to the PRA.
- (1) Firms should take sufficient care to ensure that they identify and correctly interpret the applicable regulatory reporting requirements. This includes taking sufficient care to assess the relevance and impact of new consultation papers or regulations in respect of regulatory reporting and how any changes should be implemented. Where firms lack sufficient technical expertise or are unclear on points of interpretation, they should take steps to address this (for example, by upskilling existing staff, recruiting staff with the appropriate expertise or seeking external advice).
  - (2) Metro Bank failed to adequately assess the applicable regulatory requirements concerning the risk weighting of CLIP and certain PBTL loans:
    - (a) The PRA issued publications setting out that it had exercised its discretion (as provided for by article 124 of the CRR) to impose a stricter regulatory capital treatment of CLIP loans than provided for under article 126 and updated the PRA Rulebook accordingly. Metro Bank acted with insufficient care in failing to identify this.
    - (b) Metro Bank also acted with insufficient care in its application of the relevant criteria under article 125 of the CRR to certain of its PBTL loans and by incorrectly categorising certain PBTL loans.
  - (3) Due to its failure to correctly interpret the relevant requirements with sufficient due skill, care and diligence, Metro Bank submitted inaccurate COREP returns to the PRA and incorrectly risk-weighted CLIP loans and certain PBTL loans as set out at paragraph 2.13 above.
  - (4) During the Relevant Period, Metro Bank failed to take sufficient care to ensure the accuracy of a key finding of the COREP audit report required by the PRA. Whilst the findings of the Firm's COREP audit were generally correct, and the COREP audit identified issues related to CRE classification, it did not identify the

full extent of the RWA errors. In relation to this aspect of the audit, the Firm failed to act with sufficient care in its approach, by failing to look beyond the requirements of the CRR to identify the relevant rule under the PRA Rulebook, and thereby failing to fully review its application of the relevant requirements.

### **Fundamental Rule 6**

- 1.18. Fundamental Rule 6 requires that a firm organises and controls its affairs responsibly and effectively.
- 1.19. During the Relevant Period, Metro Bank breached Fundamental Rule 6 because it failed to organise and control its affairs responsibly and effectively in order to be able to comply with its COREP reporting requirements. These failings related to: (i) governance and oversight; (ii) controls; and (iii) investment and data.

#### Governance and oversight

- 1.20. Metro Bank's governance and oversight arrangements relating to its COREP reporting fell significantly below the standards the PRA expects of a deposit-taker of the Firm's size and scale. In particular:
- (1) Metro Bank failed to ensure effective oversight and challenge of its approach to COREP reporting:
    - (a) Outside of the Finance Function, Metro Bank failed to clearly assign the roles and responsibilities of senior individuals or the Firm's Executive and Board level committees in relation to the review, challenge and oversight of RWA calculation and reporting. Furthermore, Members of Metro Bank's senior management lacked sufficient awareness and understanding of the Firm's policies and procedures relating to its regulatory reporting control framework. This limited the Firm's ability to assess whether it had adequate and effective systems, controls and procedures to ensure complete and accurate regulatory reporting; and
    - (b) The Risk Function had no formal second line oversight of RRT and COREP reporting, which meant that the Firm had inadequate assurance as to whether its regulatory reporting was accurate or reliable. Prior to May 2018, the Firm's approach to identifying the RWA issue accordingly lacked coordination between its Risk and Finance functions.

- (2) In respect of COREP reporting issues, Metro Bank's escalation routes to the Executive Leadership Team, the Board and its committees regarding regulatory reporting lacked formality, were unclear and undocumented, and failed to operate effectively.
- (3) The Audit Committee, responsible for reviewing and monitoring management responses to the findings and recommendations of internal audits, carried out limited detailed challenge regarding management actions arising from the COREP audit that were overdue.

### Controls

1.21. Metro Bank's governance arrangements for regulatory returns were not supported by an effective and robust control framework. In particular:

- (1) Metro Bank failed to establish and implement effective controls in relation to its interpretation of relevant regulatory rules and guidance relevant to its COREP reporting:
  - (a) Metro Bank failed to define, allocate or document clear roles and responsibilities for ensuring the completeness and accuracy of data used in regulatory reporting. There was no specific policy formally articulating roles and responsibilities for RWA calculation and reporting. In particular, there was no description of roles and responsibilities for data used in regulatory reporting, for example to set out the responsibilities of upstream owners and providers of data to the regulatory reporting team with regard to completeness and accuracy.
  - (b) While the RRT was responsible for regulatory rule interpretation, Metro Bank failed to formally assign responsibility for systematically analysing new consultation papers or regulations to assess their relevance or impact on the Firm's regulatory reporting and how any changes should be implemented.
  - (c) During the Relevant Period, Metro failed to document sufficiently the rule interpretations it applied in the calculation of risk weightings for its lending portfolio. To the extent that rule interpretations were documented, they were embedded within spreadsheets and working papers, and so were not readily accessible. Furthermore, Metro Bank failed to establish and implement

adequate and effective processes for reviewing and approving its regulatory interpretations, or the consistent application of those interpretations.

- (2) Metro Bank's approach to technical interpretations of COREP reporting requirements was insufficiently robust given the complexity of those decisions and the likely impact on reporting. As the Second Consultant concluded, it was "*virtually impossible to evidence the integrity of the RWA calculation or the COREP reports*" and "*there are multiple gaps in the controls framework at every stage of the process, from data sourcing through to report generation*".

#### Investment and Data

1.22. The Relevant Period was one of significant growth for Metro Bank, in which resourcing in support functions, including RRT, did not keep pace with this growth. Metro Bank failed to allocate appropriate and adequate resources to enable it to comply with its COREP reporting obligations. In particular:

- (1) Metro Bank failed to invest adequately in, or instil a culture sufficiently focused on, systems and controls related to its regulatory reporting. Though human resourcing of the RRT increased throughout the Relevant Period, the Firm failed to satisfactorily address a lack of sufficient expertise and experience within RRT or to ensure that the size of RRT grew commensurate to the Firm's own growth. Rather, the Firm had a disproportionate focus on growth, to the detriment of regulatory compliance functions such as RRT and Risk Management.
- (2) Though Metro Bank sought to make process improvements throughout the Relevant Period, its RWA calculation process remained largely manual, reflecting the Firm's limited investment in systems during the Relevant Period, which heightened operational risk and created key-person dependencies on a small number of individuals familiar with spreadsheets that were not scalable. This was inadequate for an institution of Metro Bank's increasing scale.
- (3) Metro Bank's front-end data capture and systems did not allow it to capture all relevant information that the Firm needed (e.g. on counterparty and collateral type) to accurately classify exposures and calculate risk weights for its lending portfolio. This meant the Firm was unable to calculate accurately RWA from its data.
- (4) Relevant staff did not receive training on how data should be entered into the systems relevant to the Firm's COREP reporting, reflecting a lack of investment.

## **ANNEX C: PENALTY ANALYSIS**

- 1.1. The PRA Penalty Policy for imposing a financial penalty is set out in '*The PRA's approach to enforcement: statutory statements of policy and procedure*' (September 2021), in particular in the 'Statement of the PRA's policy on the imposition and amount of financial penalties under the Act' (the "PRA Penalty Policy"). Pursuant to paragraphs 12 to 36 of the PRA Penalty Policy, the PRA applies a five-step framework to determine the appropriate level of financial penalty.
- 1.2. The PRA considered whether to calculate separate penalties in respect of the Firm's breaches of Fundamental Rules 2 and 6. However, as the systems and controls failings underpinning the misconduct in relation to these regulatory breaches are linked, the PRA concluded that a single penalty calculation was appropriate.

### **Step 1: Disgorgement**

- 1.3. Pursuant to paragraph 17 of the PRA Penalty Policy, at Step 1 the PRA seeks to deprive a person of any economic benefits derived from, or attributable to, the breach of its requirements, where it is practicable to ascertain and quantify them.
- 1.4. The PRA has no evidence that the Firm derived any economic benefit from the breaches, including profit made or loss avoided. The PRA therefore does not require the disgorgement of any sum from the Firm.
- 1.5. The Step 1 figure therefore is £0.

### **Step 2: The seriousness of the breach**

- 1.6. Pursuant to paragraph 18 of the PRA Penalty Policy, at Step 2 the PRA determines a starting point figure for a financial penalty having regard to the seriousness of the breach by the firm, including any threat it posed, or continues to pose, to the advancement of the PRA's statutory objectives, and the size and financial position of the firm.
- 1.7. Paragraph 19(a) of the PRA Penalty Policy sets out that a suitable indicator of the size and financial position of the firm may include, but is not limited to, the firm's total revenue in respect of one or more areas of its business. Paragraph 19(b) provides that, in those cases where the PRA considers that revenue is an appropriate indicator of the size and financial position of the firm, ordinarily it will calculate the firm's revenue during its last business year, which is the financial year preceding the date when the breach ended.
- 1.8. Footnote 22 of the Penalty Policy provides that where the PRA determines that revenue

is not an appropriate indicator of the size and financial position of the firm for the purposes of determining a penalty for the breach, the PRA may use an appropriate alternative indicator. Footnote 23 of the Penalty Policy provides that the PRA may have regard to any relevant considerations and these may include any unusual features of the business year in question.

- 1.9. The PRA considers that the Firm's total business revenue for the financial year preceding the date when the breach ended (2018) is not a suitable indicator of its size and financial position. Metro Bank is a challenger bank, which was undergoing rapid growth during the Relevant Period, but its financial position has since changed and its total revenue has fallen.
- 1.10. The PRA therefore considers that the appropriate starting point figure for the purposes of calculating financial penalty is the Firm's revenue from its commercial loan business in the year ended 31 December 2018, the financial year preceding the end of the Relevant Period.
- 1.11. Therefore, the starting point for the penalty is **£64,000,000**.

#### Step 2 Factors

- 1.12. Pursuant to paragraph 19(c) of the PRA Penalty Policy, the PRA applies an appropriate percentage rate ('the Seriousness Percentage') to the firm's relevant revenue to produce a figure that properly reflects the nature, extent, scale and gravity of the breaches.
- 1.13. Pursuant to paragraphs 21 to 23 of the PRA Penalty Policy, the PRA has taken the following factors into account to determine the Step 2 Seriousness Percentage:
  - (1) The provision of prudential regulatory information is fundamental to the PRA's ability to effectively supervise firms and discharge its statutory objectives. As a result, the PRA attaches considerable importance to the preparation and submission of complete and accurate regulatory returns. This is particularly the case for institutions of the Firm's increasing scale. During the Relevant Period, Metro Bank was assigned as a Category 3 firm but as it grew it was recategorised as a Category 2 firm (from June 2018). A Category 3 firm is a deposit-taker whose size, interconnectedness, complexity, and business type gave it the capacity to cause minor disruption to the UK financial system by failing or by carrying on its business in an unsafe manner, but where difficulties across a whole sector or subsector had the potential to generate disruption. A Category 2 firm is a significant

deposit-taker whose size, interconnectedness, complexity, and business type give it the capacity to cause some disruption to the UK financial system (and, through that, to economic activity more widely).

- (2) The Firm's RWA errors and the resulting RWA Adjustment was significant and, combined with other factors, had the potential to affect the PRA's objective to promote the safety and soundness of firms.
- (3) The Firm's failings persisted over a significant length of time. The Firm had been aware of data quality issues since at least 2016, and the PRA had raised concerns at that time regarding the Firm's high resubmission of regulatory returns due to errors in the original submissions.
- (4) Whilst the Firm remained in compliance with its regulatory capital requirement throughout the Relevant Period, its failings reflected systemic shortcomings in how the Firm organised and controlled its compliance with PRA regulatory reporting obligations. These failings created a risk that the Firm, and indeed the PRA, would take decisions based on inaccurate regulatory data.
- (5) The Firm's failings reflected the fact that its regulatory reporting control framework failed to keep pace with the Firm's rapid growth and fell below the standards expected of a firm of Metro Bank's increasing scale.
- (6) The Firm's breaches were not deliberate or reckless.

1.14. The PRA has also had regard to the matters set out at Annexes A and B to this Notice.

1.15. Taking all of these factors into account, the PRA considers the seriousness of the conduct to be such that the appropriate Seriousness Percentage is 20%.

1.16. The Step 2 figure is therefore  $20\% \times \text{£}64 \text{ million} = \text{£}12,800,000$ .

### **Step 3: Adjustment for any aggravating, mitigating or other relevant factors**

1.17. Pursuant to paragraph 24 of the PRA Penalty Policy, the PRA may increase or decrease the Step 2 figure to take account of any factors which may aggravate or mitigate the breaches. The factors that may aggravate or mitigate the breach include those set out at paragraphs 25 and 26 of the PRA Penalty Policy. Any such adjustments will normally be made by way of a percentage adjustment to the figure determined at Step 2.

1.18. The PRA considers that the following factors, among others, are relevant in determining whether such adjustment should be made:

- (1) The Firm has cooperated fully with the PRA's investigation. It prepared a comprehensive report, following a number of interviews with members of senior management, and provided the PRA with the benefit of that work. It also made a number of admissions as to facts and failings at an early stage, in order to help expedite resolution of the PRA's investigation.
- (2) The Firm has undertaken significant steps to remediate the issues identified, namely by: (i) implementing an extensive remediation programme to remedy the issues underlying the systems and controls which led to the RWA adjustment; (ii) carrying out significant leadership and cultural changes; and (iii) engaging external consultants to identify issues, root causes and remedial actions. Furthermore, the resulting third party reports were valuable to the PRA's investigation of the Firm's failings. Metro Bank calculates the total cost of its remediation exercise to have been over £15m.
- (3) The Firm has a strong disciplinary record with no previous regulatory disciplinary action.

1.19. On balance, the PRA considers that there are mitigating factors that would warrant a downward adjustment of 40% to the Step 2 figure.

1.20. The Step 3 figure is therefore **£7,680,000**.

#### **Step 4: Adjustment for deterrence**

1.21. Pursuant to paragraph 27 of the PRA Penalty Policy, if the PRA considers the figure arrived at after Step 3 is insufficient to effectively deter the firm that committed the breach, or others, from committing further or similar breaches, then the PRA may increase the penalty at Step 4 by making an appropriate adjustment to it.

1.22. Taking into account all the circumstances, the PRA does not consider an adjustment for deterrence is necessary in this matter.

1.23. The Step 4 figure is therefore **£7,680,000**.

### **Step 5: Application of any applicable reductions for early settlement or serious financial hardship**

1.24. Pursuant to paragraph 29 of the PRA's Penalty Policy, if the PRA and the firm upon whom a financial penalty is to be imposed agree the amount of the financial penalty and any other appropriate settlement terms, the PRA Settlement Policy provides that the amount of the penalty which would otherwise have been payable may, subject to the stage at which a binding settlement agreement is reached, be reduced.

1.25. The PRA and the Firm reached an agreement to settle during the Discount Stage. Therefore, a 30% settlement discount applies to the Step 4 figure.

1.26. The Step 5 figure is therefore **£5,376,000**.

### **Conclusion**

1.27. The PRA therefore imposes a financial penalty of **£5,376,000** on Metro Bank for its breaches of the PRA's Fundamental Rules 2 and 6.

## **ANNEX D: PROCEDURAL MATTERS**

### **1. DECISION MAKER**

1.1. The settlement decision makers made the decision, which gave rise to the obligation to give this Notice.

1.2. This Notice is given in accordance with section 390 of the Act.

### **2. MANNER AND TIME FOR PAYMENT**

2.1. Metro Bank must pay the financial penalty in full to the PRA by no later than 12 January 2022.

2.2. If all or any of the financial penalty is outstanding on 13 January 2022, the day after the due date for payment, the PRA may recover the outstanding amount as a debt owed by Metro Bank and due to the PRA.

### **3. PUBLICITY**

3.1. Sections 391(4), 391(6A) and 391(7) of the Act apply to the publication of information about the matter to which this Notice relates. Under those provisions, the PRA must publish such information about the matter to which this Notice relates as the PRA considers appropriate. However, the PRA may not publish information if such publication would, in the opinion of the PRA, be unfair to the persons with respect to whom the action was taken or prejudicial to the safety and soundness of PRA-authorized persons or prejudicial to securing an appropriate degree of protection to policyholders.

### **4. PRA CONTACTS**

4.1. For more information concerning this matter generally, contact Paul Hemingway at the PRA (direct line: 020 3461 6134, email: [paul.hemingway@bankofengland.co.uk](mailto:paul.hemingway@bankofengland.co.uk)).

## APPENDIX 1: DEFINITIONS

### THE DEFINITIONS BELOW ARE USED IN WARNING NOTICE:

1. “the Act” means the Financial Services and Markets Act 2000 (as amended);
2. “AIRB” means the advanced internal ratings-based approach to calculating RWA;
3. “AIRB Application” means the Firm’s project to seek the PRA’s permission to use the AIRB approach to calculate risk weightings for residential mortgages in the first instance, and other loan types in later phases;
4. “Basel III” means the PRA’s determination of a minimum regulatory capital level for a firm and buffers on top of this, as provided for in the PRA’s approach to banking supervision. Basel III limits the type of capital that a bank may include in its different capital tiers and structures;
5. “Basel Committee” means the Basel Committee on Banking Supervision;
6. “BTL” means buy-to-let loans;
7. “CET 1” means a bank’s capital structure which consists of Tier 2 capital, Tier 1 capital and common equity Tier 1 capital;
8. “CLIP loans” means commercial loans secured on commercial immovable property;
9. “COREP” means Common Reporting Framework, introduced to standardise the reporting of capital requirements and prudential regulatory information. COREP reports include quarterly reporting on a firm’s current assessment of its RWA;
10. “the COREP audit” means the Internal Audit function’s review of the Firm’s COREP reporting;
11. “the COREP audit report” means the final draft of the report into the Firm’s COREP reporting, circulated by Internal Audit in June 2017;

12. “CRE loans” means commercial real estate loans;
13. “CRPAC” means the Firm’s Credit Risk Policy and Appetite Committee, which was the designated committee for the purposes of the Firm’s AIRB Application and Credit Risk Model Framework;
14. “CRR” means Capital Requirements Regulation (575/2013) which governs a bank’s applicable capital requirements;
15. “Decision trees” means flow diagrams setting out a structured series of questions that the Firm asked the First Consultant to prepare in order to assist the Firm in classifying loans correctly for the purposes of calculating RWA under the standardised approach;
16. “Discount Stage” means, as provided for in the PRA Penalty Policy and PRA Settlement Policy, the early period of an investigation during which the subject of an investigation will qualify for a 30% discount to the proposed financial penalty if they enter into a settlement agreement with the PRA;
17. “EBA” means the European Banking Authority;
18. the “FCA” means the Financial Conduct Authority;
19. “the Firm” means Metro Bank plc (Firm Reference Number: 488982) also referred to throughout as “Metro Bank” or “the Firm”;
20. “the First Consultant” means the external consultancy firm that the Firm engaged in April 2018 to conduct a review of the Firm’s commercial loan classifications;
21. “ICAAP” means Internal Capital Adequacy Assessment Process;
22. “ILAAP” means Internal Liquidity Adequacy Assessment Process;
23. “Internal Audit” means Metro Bank’s Internal Audit function;
24. “Metro Bank” means Metro Bank plc (Firm Reference Number: 488982);
25. “Notice” means this warning notice, together with its Annexes and Appendices;

26. “PBTL loans” means loans that Metro Bank categorised as professional buy-to-let loans;
27. the “PRA” means the Prudential Regulation Authority;
28. the “PRA Penalty Policy” means ‘The Prudential Regulation Authority’s approach to enforcement: statutory statements of policy and procedure August 2018 – Appendix 2 – Statement of the PRA’s policy on the imposition and amount of financial penalties under the Act;
29. “PRA Rulebook” means the Prudential Regulation Authority Rulebook;
30. the “PRA Settlement Policy” means ‘The Prudential Regulation Authority’s approach to enforcement: statutory statements of policy and procedure September 2021 – Appendix 4 - Statement of the PRA’s settlement decision-making procedure and policy for the determination of the amount of penalties and the period of suspensions or restrictions in settled cases’;
31. “PSM” means Periodic Summary Meeting;
32. “Relevant Period” means the period from 13 May 2016 to 23 January 2019;
33. “RMs” means the Firm’s relationship managers across various business areas (including Commercial, Operations and Retail);
34. “RMF” means the Firm’s Enterprise Risk Management Framework;
35. “RRT” means the Regulatory Reporting Team which sat within the Firm’s Finance function;
36. “RWA” means risk weighted assets;
37. “RWA Adjustment” means the Firm’s announcement to the market on 23 January 2019 that it was making an adjustment to its assessment of its risk weighted assets for December 2018 of approximately £900 million;

38. “the RWA errors” means errors that were identified in respect of the Firm’s risk weighting of CLIP loans and PBTB loans, in addition to other errors in relation to risk weighting, that led to the RWA adjustment on 23 January 2019;
39. “SA” means the standardised approach for calculating RWA;
40. “the Second Consultant” means the external consultant that the Firm engaged in October 2018 to support a review of the Firm’s risk weighting of commercial lending;  
and
41. “the Tribunal” means the Upper Tribunal (Tax and Chancery Chamber).

## APPENDIX 2: RELEVANT STATUTORY AND REGULATORY PROVISIONS

### RELEVANT STATUTORY PROVISIONS

#### The PRA's objectives

1. The PRA has a general objective, set out in section 2B(2) of the Act, to promote the safety and soundness of PRA-authorized persons. Section 2B(3) of the Act provides that the PRA's general objective is to be advanced primarily by:
  - (a) seeking to ensure that the business of PRA-authorized persons is carried on in a way which avoids any adverse effect on the stability of the UK financial system; and
  - (b) seeking to minimise the adverse effect that the failure of a PRA-authorized person could be expected to have on the stability of the UK financial system.

#### Section 206 – Disciplinary powers

2. Section 206 of the Act provides that: *“If the appropriate regulator considers that an authorised person has contravened a relevant requirement imposed on the person, it may impose on him a penalty, in respect of the contravention, of such amount as it considers appropriate”*.
3. Metro Bank is an authorised person for the purposes of section 206 of the Act. Relevant requirements imposed on authorised persons include rules made under the PRA Rulebook, including the PRA's Fundamental Rules.

### RELEVANT REGULATORY PROVISIONS

#### PRA's Fundamental Rules

4. Fundamental Rule 2: A firm must conduct its business with due care, skill and diligence.
5. Fundamental Rule 6: A firm must organise and control its affairs responsibly and effectively.

## RELEVANT POLICY

### Approach to the supervision of banks

6. *The Prudential Regulation Authority's approach to banking supervision, April 2013 (as updated in October 2018)* sets out the PRA's approach to banking supervision.

### Approach to enforcement

7. *The Prudential Regulation Authority's approach to enforcement: statutory statements of policy and procedure, April 2013 (as updated in September 2021)* sets out the PRA's approach to exercising its main enforcement powers under the Act.
8. In particular, the PRA's approach to the imposition of penalties is outlined at Annex 2 - *Statement of the PRA's policy on the imposition and amount of financial penalties under the Act*; and the PRA's approach to settlement is outlined at Annex 4 - *Statement of the PRA's settlement decision-making procedure and policy for the determination of the amount of penalties and the period of suspensions or restrictions in settled cases*.