

Monzo Bank Ltd (formerly Focus FS Limited)

Pillar 3 Disclosures

28 February 2017

Registered number: 09446231

Introduction.....	3
Disclosures.....	3
Basis of preparation.....	3
Frequency and location of disclosures .....	3
Verification .....	3
Governance.....	4
Risk Management .....	4
Risk Culture .....	4
Risk Management Framework.....	5
Principal Risks .....	6
Strategic risk.....	6
Customer outcome risk .....	6
Operational risk .....	6
Credit risk .....	6
Financial risk .....	7
Liquidity Risk.....	7
Market Risk .....	7
Compliance risk.....	7
Three Lines of Defence .....	8
Regulatory Capital.....	9
Capital Resources .....	9
Risk Weighted Assets.....	10
Remuneration policy and practices .....	12
1. Remuneration Governance.....	12
2. Remuneration Policy.....	12
3. Performance Framework .....	13
4. Remuneration .....	14
Appendix 1: EBA own funds disclosure template.....	16

# Introduction

This document constitutes the Pillar 3 disclosures of Monzo Bank Ltd ('the Bank') as required under the Capital Requirements Regulation (CRR) and the Capital Requirements Directive (together referred to as CRD IV). The purpose of this document is to provide information and disclosure to the Bank's depositors and other stakeholders, in relation to the internal procedures and policies adopted by the Bank to manage and mitigate its key risks. As such, it includes details of:

- The approach to risk management, its policies and objectives;
- The governance structure of the Bank, including Board and committees;
- Asset information and capital resources; and
- Compliance with EU Capital Requirements legislation.

Disclosures are presented as at 28th February 2017. As at this date, Monzo was still in mobilisation, the period between being granted a restricted banking licence and when Monzo received its full licence. This Pillar 3 is based on this date and as such Monzo did not have any current accounts or deposits, but operated a prepaid card scheme. Monzo had its restrictions lifted and was granted a full banking licence in April 2017.

## Disclosures

### Basis of preparation

The Capital Requirements Regulation (CRR) (EU Regulation No 575/2013) and the fourth Capital Requirements Directive (CRD) (EU Directive 2013/36) were implemented in the UK on 1 January 2014 and are collectively known as the CRD IV package (CRD IV). Monzo's Pillar 3 disclosures comply with the requirements of CRD IV including any implementing and delegated legislation and any European Banking Authority (EBA) guidelines in force at 28 February 2017.

### Frequency and location of disclosures

Monzo's policy is to publish the disclosures on the company website [www.monzo.com](http://www.monzo.com) on an annual basis.

### Verification

The Bank's Pillar 3 disclosures have been reviewed and approved by the Board of Directors. The Board considers that, as at 28 February 2017, it had in place adequate systems and controls with regard to the Bank's risk profile and strategy. Furthermore, the Board can confirm that the Bank remained within defined limits for risk exposure throughout the year for credit, operational and prudential risks.

# Governance

Our governance structure has been developed to support our launch as a bank. It comprises a Board of Directors supported by 4 Board Committees, each of which has membership drawn from the independent non-executives on the Board. The 4 committees are:

- Risk and Compliance Committee
- Audit Committee
- Remuneration Committee
- Nomination Committee

Day to day running of the business is delegated to the CEO who has established 2 Management Committees to support him; an Executive Committee for general business matters and an Assets and Liability Committee on Balance Sheet matters.

# Risk Management

## Risk Culture

We take the responsibility of being a bank very seriously and know that Monzo is exposed to a number of risks. Identifying, assessing and managing those risks is central to the way the Bank is run. We believe a transparent, prudent, sustainable and ultimately profitable business with robust levels of capital and liquidity will afford the greatest protection to customers, shareholders and wider society. We have also thought carefully about and prepared plans to recover and if necessary resolve the bank without detriment to customers and wider society.

Whilst certain individuals will have specific responsibility for some aspects of our risk management framework e.g. the CRO as the leader of the second line of defence, the Board of Directors is clear that every employee must and will play their part in identifying, managing and controlling risks. An open culture of transparency and learning is at the heart of our risk management culture.

# Risk Management Framework



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**1. Appetite:** Monzo’s Risk Appetite is set by the Board and set the appetite for how much risk we are willing to take organised according to our Principal Risks (see below)

**2. Policies:** The Bank’s Policies are aligned to Principal risks and guide the way the business is managed through qualitative and quantitative policy statements and limits. Policies are approved by the Monzo Board.

**3. Organisation:** Monzo is organised under a “Three Lines of Defence”. The Lines of Defence structures our organisation to give our front line staff the responsibility and tools to conduct business while adhering to our policies and within our risk appetite, and ensuring that the second and third lines can provide sufficient challenge, oversight and independent assurance. See below for more information.

**4. Process:** Various procedures, tools, techniques and templates have been established by the Risk and Compliance team (2nd Line of Defence) to support the deployment and embedding of the risk strategy and risk management framework.

**5. Reporting and MI:** Management information is used to monitor and assess the Risk and Compliance of the bank, at a top level this comprises the Board Key Risk Indicators (KRIs) and Early Warning Indicators (EWIs).

**6. Governance:** Monzo's governance structure has been developed to recognise the responsibilities and structure required of a financial services firm, taking into account the current size and scale of the business. Monzo follows the principles of the UK Corporate Governance Code. This approach provides a solid foundation that can be scaled over time in line with business growth.

## Principal Risks

### Strategic risk

The core strategy of Monzo will challenge traditional banking models and norms. Whilst implementing that strategy, we are likely to encounter situations or circumstances which cause disruption to our business plan in terms of revenue streams, cost base, speed to market or customer engagement. These may include external market and competitor factors that impact the overall reputation of the sector.

### Customer outcome risk

Monzo has a simple business model, easy to understand products and a great customer proposition. This assists the bank in preventing systemic unfair customer outcomes which may arise through a poor sales culture, inadequate product design, underperformance on our servicing commitments or failings in our firm governance.

### Operational risk

As a fast growing business, exposed to a changing risk profile, even when we believe that we understand and manage our risks, things will go wrong from time to time, and we will incur operational losses. Monzo's operating model and culture allows early identification and swift responses to such situations which helps to mitigate operational risk losses and impacts. We expect our biggest operational financial losses to arise from debit card fraud and operational impacts related to issues driven by our rapid growth, agile development and change management approaches. Ensuring we have a robust approach for Information security and data protection is a top priority, in order to reduce the risk of cyber-attacks and protect our customer data.

### Credit risk

In the longer term, customer lending is central to the business model and strategy. Recognising that it will take time to build-up experience in this area, the Bank intends to take a conservative and cautious approach in the first year. Wholesale credit risk will be minimised by placing surplus deposits with the Bank of England Reserve Account. Other than this, the other balances are collateral posted to payment schemes such as MasterCard and Wirecard.

Monzo does not hold trading book instruments or foreign exchange positions on the balance sheet and keeps all its surplus funds with the Bank of England. It is therefore not exposed to any material levels of counterparty credit risk.

## Financial risk

Monzo has a simple business model and balance sheet and maintains adequate capital at all times, including through periods of stress. The Bank will be adequately capitalised on a regulatory basis with strong Tier 1 and Total Capital Ratios.

## Liquidity Risk

The bank is risk averse when it comes to liquidity because of the harm this may cause to customers and the bank. In addition to being able to meet our everyday liabilities as they fall due, we maintain an overall level of liquidity to ensure that Monzo can survive the most draconian of an idiosyncratic, market wide and combined stress test over a 90 day period. However, in practice the Bank's decision to place surplus funds with the Bank of England means in practice it can survive much longer periods of cash outflow.

## Market Risk

Monzo does not hold trading book instruments or hold foreign exchange positions on the balance sheet. As such, the Bank is not exposed to direct losses in relation to market risk.

## Compliance risk

Monzo has adopted a risk based approach and our policies, processes and procedures enable all employees to understand and evidence compliance with the laws, regulations, rules and principles as they apply to their role in the Bank, and reduce the likelihood for compliance risk that would result in breach of regulation or poor customer outcomes.

# Three Lines of Defence

Monzo has adopted a Three Lines of Defence approach:

<b>Board of Directors</b>		
<b>1st Line of Defence</b>	<b>2nd Line of Defence</b>	<b>3rd Line of Defence</b>
Business Unit	Risk & Compliance	Internal Audit
Take & Manage Risk	Set Risk Policy & Monitor Risk Profile	Validate & Provide Assurance
Conduct business in accordance with agreed strategy and related risk appetite and limits	Establish risk management framework to include appetite, policies, procedures, methodologies and tools and make available to all	Perform independent testing and assess whether risk appetite framework, risk policies, risk procedures and related controls are functioning as intended
Promote strong risk culture and sustainable risk: return decision making	Facilitate establishment of risk appetite statements with input from senior management and board, set limits and gain board approval	Perform independent testing and validation of business unit risk and control elements
Establish and operate a business unit risk and control structure to ensure area of responsibility operates within agreed policies and risk limits	Monitor risk limits and communicate with the Exco and Board regarding exceptions	Provide assurance to management and board related to the quality and effectiveness of the risk management framework
Conduct rigorous self-testing against established policies, procedures and limits	Monitor compliance with legislation and regulation and communicate with the Exco and Board regarding exceptions	
Perform thoughtful, periodic risk self-assessments	Provide independent risk oversight across all risk types, business units and locations	
Report and escalate risk events and incidents		



# Regulatory Capital

## Capital Resources

### Movement in capital resources

Monzo raised £24m in the year to February 2017 to fund growth in the business. The closing CET1 capital position at year end was £18m. Throughout the year Monzo was fully compliant with regulatory capital requirements including all relevant capital buffers.

### £'000s

	Share capital	Share premium £'000	Other reserves £,000	Retained losses £'000	Total equity £'000
Balance as at 18 February 2015	-	-	-	-	-
Shares issued	-	2,000	-	-	2,000
Share based payments reserve	-	-	14	-	14
Losses for the period	-	-	-	(1,446)	(1,446)
<b>Balance as at 29 February 2016</b>	<b>-</b>	<b>2,000</b>	<b>14</b>	<b>(1,446)</b>	<b>568</b>
<b>Balance as at 1 March 2016</b>	<b>-</b>	<b>2,000</b>	<b>14</b>	<b>(1,446)</b>	<b>568</b>
Shares issued	-	24,288	-	-	24,288
Cost of issuance	-	(63)	-	-	(63)
Share based payments reserve	-	-	294	-	294
Exercise of options	-	73	(73)	-	-
Losses for the year	-	-	-	(6,689)	(6,689)
<b>Balance as at 28 February 2017</b>	<b>-</b>	<b>26,297</b>	<b>235</b>	<b>(8,134)</b>	<b>18,398</b>
Less intangible assets					(24)
CET1 capital					18,374
RWA's					16,590
CET1 ratio					111%

### Capital ratios

Monzo was compliant with internally and externally imposed capital ratios throughout the year to February 2017. See appendix 1 for more details.

## Risk Weighted Assets

Monzo's risk weighted assets are mainly comprised of credit risk exposures to financial institutions and operational risk, calculated using the standard and basic indicator approaches respectively.

### RWAs for Year End 2017

£'000s	RWAs	Pillar 1 Capital
Credit Risk	3,587	287
Operational Risk	13,003	1,040
<b>Total</b>	<b>16,590</b>	<b>1,327</b>

### Credit Risk

Credit risk is the risk that an asset changes in value due to changing valuation or that a customer or counterparty of the Bank defaults on their contractual obligations to Monzo, or fails to perform their obligations in a timely manner.

Monzo holds short term credit risks against financial institutions such as our correspondent bank and the operator of our prepaid card scheme, and in the future will have a credit risk against customers that Monzo has lent money to.

### Pillar 1 Credit Risk Capital Requirement as at Year End 2017

£'000s	Exposure	RWA	Pillar 1 Capital
<b>Government and central banks</b>	5,039	0	0
<b>Institutions</b>	13,696	2,868	229
<b>Other</b>	542	542	43
<b>Fixed Assets</b>	177	177	14
<b>Total</b>	<b>19,478</b>	<b>3,587</b>	<b>287</b>

**Operational Risk**

Operational risk is the risk of loss, whether direct or indirect, to which Monzo is exposed due to inadequate or failed internal processes or systems, human error or external events.

Monzo uses the basic indicator approach to determine Pillar 1 requirements for operational risk, which uses an average of the last three years operating income to determine the Pillar 1 requirement. This requirement is equal to 15% of the average annual operating income over a three year period. As Monzo has not been trading for three years it uses the average of past and future years revenue.

**Leverage Ratio as at Year End 2017**

<b>Leverage Ratio</b>	<b>2017</b>
£'000s	
Balance Sheet	
Assets	19,478
Less Intangibles	-24
Total	19,454
Regulatory Capital	18,398
Less Intangibles	-24
Total	18,374
Leverage Ratio	94.45%

The leverage ratio measures the relationship between Monzo’s core tier 1 capital and the firm’s assets, to calculate capital adequacy. The leverage ratio is compliant with internal and regulatory requirements.

# Remuneration policy and practices

This section provides details of Monzo's Remuneration governance, policies and practices:

1. Remuneration Governance
2. Remuneration Policy
3. Performance framework
4. Remuneration

## 1. Remuneration Governance

The Remuneration Committee (RemCo) is responsible for oversight of remuneration in Monzo Bank.

### Chair

Baroness Denise Kingsmill, (Chairman of the Board)

### Members

In addition to the Chair of the Remuneration Committee Quorum is two independent Non-Executive Directors from:

- Tim Brooke (Chair of Audit Committee)
- Keith Woollard (Chair of Risk and Compliance Committee)
- Amy Kirk (iNED)

### Meeting Frequency

As required by the committee but at least once per annum

### Purpose of this Committee

Responsible for remuneration and expense policy for senior management and overseeing the wider remuneration scheme for Monzo Bank.

## 2. Remuneration Policy

Our policy sets a framework to ensure we can attract the best talent, without breaching regulations, fair employment laws or our obligation to our staff to pay them fairly and in line with their skills, experience and contribution.

### Policy Statements:

1. Monzo aims to attract, develop and retain the best talent available in the marketplace as the foundation for becoming a truly customer and colleague centric organisation
2. Our remuneration framework is structured to favour fixed pay over variable remuneration and to align the latter to discourage risk taking that is not in line with our risk appetite.

3. Our Remuneration for Material Risk Takers (Code Staff) promotes sound and effective risk management, and we follow the Dual-Regulated Firms Remuneration Code where it applies to us
4. Monzo firmly believes in equal pay for equal work. Monzo does not tolerate any discrimination in remuneration based on criteria other than past experience, qualifications, skills and level of contribution.

### 3. Performance Framework

Our performance framework is designed to ensure that we discourage risk taking which is outside of our risk appetite. Feedback and appraisal processes help us to nurture a committed, engaged and high performing team focused on delivering excellent customer outcomes. Our feedback cycle includes formal appraisals, identifying areas for personal improvement and development, and performance management. Feedback is expected to cover measurable performance and behaviours including operating within Monzo's risk appetite and protecting its reputation. We do not give variable rewards directly related to sales or financial performance. As a crucial part of the employee lifecycle, this links in with the criteria we use for hiring exceptional people, building strong functional teams, and developing our employees. Formal appraisals contribute to promotion and compensation decisions, as well as decisions to terminate employment for those who are not contributing to the company as expected or are found to be operating outside our risk appetite.

We expect everyone to give and request feedback very frequently. The aim of formal appraisals is to ensure that every single person in the team receives some useful, long-term feedback, and is able to reflect on their personal and professional development, to direct this in line with the company.

#### **Ongoing informal feedback**

All staff are encouraged to give in the moment feedback based on behaviour or actions they have seen in their colleagues, whether direct reports or not, or, more or less senior to them. Staff are encouraged to take 1 to 1 meetings with members of their team, or other people they work with and engage with to solicit further feedback.

#### **Written, semi-annual reviews.**

More formal written appraisals are delivered twice each year by an individual's manager. There are three stages to the written appraisal process:

1. **Feedback collection:** Qualitative feedback collected from all employees - peers, mentors and any direct reports and used to gather the individual's own thoughts on their performance
2. **Written review document:** The person's manager writes an overall appraisal of the employee's performance, incorporating both feedback from peers and their own view of the employee's work in the preceding months. The final document is shared with the employee.

3. **Feedback discussion:** The manager and employee meet to discuss the written review document, and to begin a development plan. Areas of outstanding performance are celebrated, and areas for improvement are raised and discussed.

## 4. Remuneration

We believe Remuneration is an important way of encouraging, directing and rewarding staff and management behaviours in line with Monzo's strategy, values and risk appetite.

### Fixed Remuneration

Fixed remuneration is determined based on our salary framework. Criteria in the framework:

- Experience and skills that relate to the role
- Impact on business, and the individual's level of responsibility and ownership
- Conduct, communication within and outside the team, and contributions to Monzo's culture
- Exhibiting an understanding of the company risk appetite and remaining within this at all times.

The salary levels in the framework are reviewed every year, benchmarked against salaries paid in the broader market and the business's position. Each individual's salary is reviewed, but not necessarily changed, at least twice a year.

### Variable Remuneration

Monzo's remuneration package for all members of the staff includes an equity component in the form of share options which is agreed when a staff member joins the team. We believe that all employees should participate in the long-term success of the firm.

In addition, and only for highest performing employees we may grant further share options as a one off bonus. These share options also follow the same vesting schedule (see below), and are granted in line with the semi-annual review process. No staff member received bonus options worth more than 100% of salary (calculated as current share price minus option strike price).

Variable remuneration was only in the form of share option grants in the year 2016/17, we did not grant any cash bonuses.

### Share option scheme

All share options granted follow a standard vesting schedule over four years with a one year cliff and monthly pro-rata vesting thereafter.

- This means that if a staff member leaves before they have been in employment for one year all of their options will lapse
- If a staff member leaves after one year and is a "good" leaver then they receive one quarter of their options and a monthly pro rata of the remaining three quarters

- If a staff member leaves after four years and is a “good” leaver they will receive all of their options
- In addition, we are entitled to claw back all options granted (even those that have vested) in case of a staff member being dismissed for misconduct

### **Company Share Option Plan (‘CSOP’) scheme**

Most options are granted under the HMRC approved CSOP scheme which has the following characteristics:

- Option strike price is agreed with HMRC
- Options need to be held for a minimum of three years
- Options awarded to an employee cannot exceed £30,000 (based on the value on the date they were awarded), however the effective value at issue is zero because the options are priced at the current agreed valuation of the company and will only yield a benefit for the employee if the value of the company’s shares increases

# Appendix 1: EBA own funds disclosure template

This template outlines our risk weighted assets and our overall capital profile. This template is based on Regulation (EU) 1423/2013 Annex IV. Any blank cells in the template have been removed from this disclosure.

<b>Common Equity Tier 1 (CET1) capital: instruments and No. reserves</b>	<b>£'000s</b>
1 Capital instruments and the related share premium accounts	26,297
2 Retained earnings	-1,446
3 Accumulated other comprehensive income (and other reserves)	235
<b>Common Equity Tier 1 (CET1) capital before regulatory 6 adjustments</b>	<b>25,086</b>
<b>Common Equity Tier 1 (CET1) capital: regulatory adjustments</b>	
8 Intangible assets (net of related tax liability) (negative amount)	-24
25a Losses for the current financial year (negative amount)	-6,689
28 Total regulatory adjustments to Common Equity Tier 1 (CET1)	6,713
29 Common Equity Tier 1 (CET1) capital	18,374
59 Total Capital	18,374
60 Risk-weighted assets	16,590
<b>Capital ratios and buffers</b>	
61 Common Equity Tier 1 (as a percentage of total risk exposure amount)	111%
62 Tier 1 (as a percentage of total risk exposure amount)	111%
63 Total capital (as a percentage of total risk exposure amount)	111%