This Interim Financial Report 2016, glossary of terms and an investor presentation are available within the Investor Relations section of our website www.co-operativebank.co.uk/investorrelations.

FORWARD LOOKING STATEMENTS

Certain terms

The term the 'Bank' means The Co-operative Bank plc together with its consolidated subsidiaries. The term 'Company', refers to The Co-operative Bank plc. In this report the abbreviations '£m' represent millions of pounds sterling, and '£bn' represents billions of pounds sterling.

Unless otherwise stated, the income statement analyses and compares the 6 months to 30 June 2016 to the corresponding 6 months of 2015. The balance sheet comparisons relate to the corresponding position as at 31 December 2015. Unless otherwise stated, all disclosed figures relate to continuing operations. Relevant terms that are used in this document but are not defined under applicable regulatory guidance or International Financial Reporting Standards (IFRS) are explained in non-IFRS measures below.

Non-IFRS measures

Certain non-IFRS measures are provided within this report. These can be found mainly (but not exclusively) in the Detailed Financial Review and the Key Highlights page.

Forward-looking statements

This document contains certain forward-looking statements with respect to certain of the Bank's strategy, plans and its current goals and expectations relating to its future financial condition and operating performance. The Bank cautions readers that no forward-looking statement is a guarantee of future performance and that actual results could differ materially from those contained in the forward-looking statements. These forward-looking statements can be identified by the fact that they do not relate only to historical or current facts. Forward-looking statements sometimes use words such as 'may', 'will', 'seek', 'continue', 'aim', 'anticipate', 'target', 'projected', 'expect', 'estimate', 'intend', 'plan', 'goal', 'believe', 'achieve', 'predict', 'should' or in each case, their negative or other variations or comparable terminology, or by discussion of strategy, plans, objectives, goals, future events or intentions. These forward-looking statements include all matters that are not historical facts. Examples of forward-looking statements include, among others, statements regarding the Bank's future financial position, income growth, assets, impairment charges, business strategy, capital ratios, leverage, payment of dividends, the industry in which the Bank operates, projected costs, commitments in connection with the 2016-2020 Updated Plan, estimates of capital expenditures and plans and objectives for future operations and other statements that are not historical fact.

By their nature, forward-looking statements involve risk and uncertainty because they relate to events and depend on circumstances that may or may not occur in the future, for example, macroeconomic and business conditions, the effects of continued volatility in credit markets, market related risks such as changes in interest rates and foreign exchange rates, effects of changes in valuation of credit market exposures, changes in values of issued notes, the policies and actions of governmental and regulatory authorities (including requirements regarding capital and group structures and the potential for one or more countries exiting the Eurozone), changes in legislation, the further development of standards and interpretations under IFRS and prudential interpretation and application of standards under IFRS, the outcome of current and future legal competition, a number of such factors being beyond the Bank's control. As a result, the Bank's actual future results may differ materially from the plans, goals and expectations set forth in the Bank's forward-looking statements. Forward-looking statements are not guarantees of future performance. In addition, even if the Bank's results of operations, financial condition, and the development of the financial services industry are consistent with the forward-looking statements in this document, those results or developments may not be indicative of results or developments in subsequent periods.

Readers are advised to read, in particular, the Principal Risks and Uncertainties section for a summary of factors that could affect the Bank's future performance. In light of these risks, uncertainties and assumptions, the events and targets described in the forward-looking statements in this document may not occur.

Any forward-looking statements made in this document speak only as of the date they are made except as required by the FCA, the PRA, the LSE or applicable law. The Bank expressly disclaims any obligation or undertaking to release publicly any updates or revisions to any forward-looking statements contained herein to reflect any change in the Bank's expectations with regard thereto or any change in events, conditions or circumstances on which such statement is based. The reader should, however, consult any additional disclosures that the Bank has made or may make in documents it has published or may publish via the Regulatory News Service of the LSE.

KEY HIGHLIGHTS

The Co-operative Bank plc
17 August 2016

2016 Interim Results for the six months ended 30 June 2016

- A viable Core Bank continues to emerge as evidenced by the positive Core Bank operating result of £17.1m in H1 2016 compared to a loss of £26.2m in H1 2015. Overall Bank losses before tax narrowed to £177.0m in H1 2016 (H1 2015: £204.2m), and while ahead of plan, this incorporates a number of individually significant items including the gain from the sale of the Visa Europe share (£58.1m) and the fair value unwinds related to the merger with Britannia Building Society of £97.2m (H1 2015: £54.3m) which will not necessarily recur and are non-operational in nature.

- Total operating expenditure reduced to £222.8m for H1 2016 (H1 2015: £262.9m), reflecting the progress made in the cost reduction programme.

- Customer service excellence was maintained with the Bank's current account Net Promoter Score (NPS) increasing to 26 at the end of the first half from 24 in the same period in 2015, with the Bank still ranking #3 among its peers. The Bank has moved back into the Top 50 brands for customer service, climbing 46 places from last year.

- Conduct and legal risk charges were £21.1m in H1 2016 (£49.0m in H1 2015). The main driver of the uplift was a charge of £33.5m for PPI predominantly due to the delay to the proposed time bar on claims as set out in the latest FCA consultation paper. The Bank has completed 95% of the required remediation for non-compliance with technical provisions of the CCA and the half year position includes a £10.7m release following a detailed review of the remaining cases yet to be remediated. Current mortgage remediation activities were substantially progressed in H1 2016 and the existing programme was 91% complete at the end of June 2016. Work to address these in-scope conduct issues is on schedule and will be materially complete by year end.

- Executive succession plan in place with appointment of Liam Coleman as Deputy Chief Executive Officer to succeed Niall Booker as Chief Executive Officer on 1 January 2017; appointment of John Worth, subject to regulatory approvals, to succeed John Baines as Chief Financial Officer in September 2016.

- The successful move of the first set of systems (SWIFT, CHAPS and Treasury back office applications) into a new data centre operated by IBM in April 2016 was a significant milestone and the ESO programme is on track to meet its key 2016 disaster recovery deliverables.

- Common Equity Tier 1 (CET1) ratio stood at 13.4% at 30 June 2016 (31 December 2015: 15.5%) reflecting a reduction in Risk Weighted Assets (RWAs) of £0.2bn and a statutory loss after tax of £132.1m.

- Non-Core customer assets reduced to £4.1bn at 30 June 2016 from £4.9bn at the end of 2015 resulting in a reduction of £0.7bn of RWAs. This was due to a combination of deleveraging and the transfer of performing assets into the Core Bank. The Bank incurred a loss on asset sales of £11.6m (H1 2015: £38.2m) as a result of the slower pace of these deleveraging activities.

- The Bank's 30 June 2016 total capital ratio stood at 19.7% compared to 21.6% at the end of 2015.

- Net interest margin increased by 10bps in H1 2016 to 1.42% (H1 2015: 1.32%). This improvement is due to a combination of deposit repricing, managed reduction in overall deposit levels and mix change.

- Remediation and strategic project expenditure was greater than planned in H1 2016 at £106.0m (H1 2015: £84.7m) as the Bank delivers the transformation required to address the historic under-investment in systems and processes.

- Stability of the franchise was evident as total Core Bank net customer loans increased to £15.4bn as at 30 June 2016 (31 December 2015: £14.7bn) as mortgage origination continued to improve with completions for the six months to 30 June 2016 totalling £1.5bn (H1 2015: £1.1bn) and redemptions (excluding contractual repayments) falling to £0.7bn during the same period (H1 2015: £1.0bn). In addition, £348m of performing PFI and REAF assets were transferred into Business and Commercial Banking (BaCB).

Implications of the EU referendum:

- There is no immediate operational impact on the Bank given its UK-only footprint and the Bank will continue to engage with customers in the same way.

- The UK macroeconomic uncertainty that has followed the EU referendum result could impact the Bank's operating environment in the following ways:

    - The reaction of UK banks to the Bank of England stimulus package;

    - possible contraction of UK mortgage market would impact Core Bank loan book growth;

    - lower for longer interest rates will restrict ability to widen NIM and consequently organic capital generation, as well as Return on Tangible Equity and cost:income ratio development. Still targeting sustainable Core Bank operating profitability in late 2017;

    - consequential impact on timing of the Bank meeting Individual Capital Guidance (ICG) and compliance with PRA Buffer. The Bank now expects to meet ICG by the end of the plan;

    - consequential impact on management of the project portfolio as reductions in income may drive further reductions in costs and project spend;

    - higher unemployment and lower property prices could mean higher levels of impairments; and

    - timing and loss characteristics of the Corporate CoAM deleverage programme.

Niall Booker, Chief Executive Officer, said:

“The progress made during the first six months of the year has delivered a small Core Bank operating profit for the second successive half year period with mortgage originations remaining strong, an improved current account proposition, customer satisfaction scores at their highest level since 2013 and widening jaws between income and costs. In addition, with further investment in our digital channels to modernise the business around how customers want to bank today and significant progress on our major transformation and remediation programmes, much has been done.

“However, as we’ve said many times before, addressing the Bank’s historic legacy issues will continue to impact our overall financial performance until the end of our plan period. The headline losses and the resulting reduction in the Bank’s Common Equity Tier 1 ratio were therefore flagged previously, and while losses have reduced year on year, the potential for headwinds in the economy as a whole presents further challenges. Spending on the continued delivery of our significant remediation and transformation projects has been higher than planned during the first half of the year but the bulk of this spending is offset by other one-time gains in H1. The increasing focus of future project spend will be on those projects generating a positive net present value, and which are more focused on business needs going forward than remediating past problems. This is positive.

"As noted by others, today’s market conditions are challenging for all retail focused banks and the macroeconomic uncertainty following the result of the EU referendum, including the likelihood of lower for longer interest rates, may restrict our ability to grow revenue in the short term.

“With regard to Executive succession, the previously announced appointments and those being announced today represent an orderly succession process, ensuring the Bank is in capable hands going forward.

“We have always been clear that turning the Bank around would be a significant journey of at least five years and so far the overall story remains one of progress and improvement. Much has been achieved in de-risking the Bank, in strengthening our resilience, in improving our IT platform, in demonstrating our values and ethics in action and in ensuring good outcomes for customers. Despite the challenges ahead, we continue to make progress building a differentiated, resilient bank which is valued by our customers for the quality of its service and I would like to thank colleagues for their hard work and dedication in meeting our customers’ needs.”

CHAIRMAN’S STATEMENT

In the first half of 2016, The Co-operative Bank continued to make good progress in transforming the business into a simpler and more efficient Retail and SME bank. We have continued to address and reduce areas of significant risk and this has contributed to improving the potential longer term viability of the Bank. I am encouraged by the progress we are making and that we are gradually seeing a viable Core Bank emerge. Full details are contained in the Chief Executive’s Interim Statement.

Recognising that several of the current Executive team joined the Bank in 2013 to lead it through the crisis management phase, the Board has continued to focus on Executive succession. Following the appointment of Liam Coleman as Deputy Chief Executive on 3 May 2016, I am pleased to confirm that Liam will succeed Niall Booker as Chief Executive, subject to regulatory approval, when Niall's contract with the Bank expires on 31 December 2016 following a planned handover during the fourth quarter of 2016. Niall, who always intended to leave at the end of his contract, has done an outstanding job in leading the Bank through the first three years of the turnaround, notably the work to de-risk the Bank by improving capital resilience and deleveraging Non-core, reducing costs and rebuilding the Core Bank by repositioning the brand and driving the digital agenda and building succession. I will say more about these achievements at the end of this year. We also look forward to welcoming John Worth to the Bank, subject to regulatory approval, as our Chief Financial Officer in September 2016 and he will join the Board when John Baines steps down as a Director on 28 September 2016. I would like to formally thank John for his significant work in the early stages of recapitalisation and in overseeing the first part of the Bank’s turnaround.

The Co-operative Group Limited, the Bank's largest shareholder, has taken up its right under the Bank's articles of association to appoint a Non-Executive Director of the Bank. Alistair Asher, General Counsel of The Co-operative Group, will become a member of the Board with effect from 12 September 2016 and will not be considered independent for the purposes of the UK Corporate Governance Code. We look forward to welcoming Alistair to the Board.

As we have said before, the transformation required to rebuild The Co-operative Bank is a significant endeavour. On behalf of the Board, I would like to thank our colleagues for their continuing commitment to our customers and our business, our customers for their continued loyalty and our investors for their continued support.

Dennis Holt
Chairman
17 August 2016

CHIEF EXECUTIVE’S INTERIM STATEMENT

Overview

During the first half of 2016, we have taken further steps in implementing the Bank’s Updated Plan and a sustainable Core Bank, differentiated by values and ethics, continues to emerge. The Core Bank has recorded a small operating profit for the second successive half year period, reflecting reduced costs, increased non-interest income and increased mortgage originations, aided by some one-off items. We also show further improvements in Net Promoter Score (NPS) and customer satisfaction.

We have continued to de-risk the Bank by improving operational resilience with significant progress in the outsourcing of our IT infrastructure and on key conduct remediation programmes, a number of which are almost complete. Remediation and strategic project expenditure remained high in H1 2016 as the Bank delivers the transformation required to address the historic under-investment in systems and processes but this was offset by one-off gains.

As we have said before, the performance of the overall business continues to reflect the impact of legacy issues. Furthermore, macroeconomic uncertainty and the interest rate outlook contribute to a more challenging environment for banks generally.

Despite this, the overall position is one of progress and improvement as we continue to de-risk the business and implement our plan to create a sustainable and secure Retail and SME bank, underpinned by values and ethics, for the benefit of all our stakeholders.

Emergence of a viable Core Bank
The Core Bank recorded an operating profit of £17.1m in H1 2016, which follows an operating profit of £11.2m in H2 2015, and compares to an operating loss of £26.2m in H1 2015. A number of one-off items have contributed to this but the underlying trends remain encouraging.

We have continued to see strong mortgage performance, with completions and redemptions for the half year totalling £1.5bn and £0.7bn respectively compared to £1.1bn and £1.0bn in the first half of 2015. Although prime current account numbers have fallen slightly, current account balances have increased from £3.8bn at the end of 2015 to £4.0bn at the end of H1 2016 coinciding with the launch of our new Everyday Rewards current account proposition.

As we have previously said, fixing the legacy issues of the past continues to impact on the overall financial performance of the business and the statutory loss before taxation for the first half of 2016 was £177.0m, compared to £204.2m in the first half of 2015 and compared to £406.4m in the second half of 2015. More information on the main drivers of the loss and the Bank's financial performance is included in the Detailed Financial Review, but the largest drivers of loss remain the Fair Value Adjustment unwind and the cost of transformation.

The marketing campaign that we launched to support our new Everyday Rewards current account proposition is indicative of the approach we are taking to rebuild our brand around customers who make a difference in their communities and to meet our customers' needs for simple and rewarding products. Our progress in this area is evidenced by the Institute of Customer Service recognising the Bank as the most improved banking brand and ranking us as a top 50 organisation for customer service. In addition, our Current Account NPS has risen to its highest level since 2013, climbing to 26 in the first half of 2016 from 24 at the end of 2015, reinforcing our position of third in the market which we have held since January 2015. These achievements reflect the continued excellent service that our colleagues continue to deliver and helps distinguish us in the market place, and show that our Core Bank franchise has remained stable in the first half of 2016.

An important component of our differentiation is our customer led Ethical Policy. In this context, I am delighted that in H1 2016, we reached the milestone where our customers have now donated over £5m to Oxfam over the course of a 20 year relationship between Oxfam and the Bank. In addition, our previous £125 current account switching incentive, which finished at the end of 2015, raised over £500,000 for our charity partners. Furthermore, the 2015 Values and Ethics Report was published in June 2016 highlighting how our Ethical Policy has benefitted our customers and the wider community. An example of this is the continuing campaign, in partnership with Refuge, to raise awareness and support the victims of financial abuse.

Across the industry, customers continue to increase their use of digital devices for everyday banking needs. Investment in our digital channels is a key component of our plan to build a more efficient Core Bank and digital transaction volumes have continued to increase, with an offsetting reduction in branch transaction volumes, as we have continued to improve our personal online banking service. In May 2016 our latest mobile and tablet friendly update increased our online payments functionality and made it easier for our customers to bank how, where and when they choose.

We have continued to improve how we deal with customer complaints, and the introduction of a new complaints management system across all customer facing channels is aligned to the recently introduced FCA guidelines. We have a seen a reduction in FOS complaints as a proportion of overall complaints and a reduction in the proportion of FOS complaints upheld in H1 2016. These improvements are the welcome results of our persistent efforts to hold ourselves accountable to our Customer Standards and ensure the best possible outcomes for our customers across all areas of the Bank. Encouragingly, we have made significant progress with key conduct remediation programmes, a number of which are almost complete. More information can be found in the Detailed Financial Review.

Capital
The overall economic climate has made Non-core deleverage more challenging. As a result, the overall reduction in RWAs has decelerated during the first half of 2016 with total RWAs standing at £7.2bn at H1 2016. As expected, the overall Bank losses incurred during H1 have led to a further reduction of the Bank's capital resources and without an offsetting reduction in RWAs this led to a reduction in our CET1 ratio from 15.5% at the end of 2015 to 13.4% at the end of June 2016.

Although we are yet to receive formal notice of MREL requirements from the Bank of England (BoE), we continue to assess whether there is any opportunity to issue MREL qualifying instruments earlier than planned. So far this has not been possible.

Resilience
We have continued to focus on the full embedding of the Risk Management Framework in the Bank, streamlining risk governance, strengthening risk leadership, agreeing key detailed appetites for each risk type and implementing comprehensive and forward looking risk reporting. This is a

priority and we are rolling out enhanced risk training and awareness to all colleagues to ensure that risk is recognised as part of everyone's job. This is a critical part of our ongoing work to further improve the culture of the Bank, and is an area where progress has continued to be made in 2016.

In April 2016, an important resilience milestone was reached in the Enterprise Services outsourcing programme with the successful move of the first set of systems to the new IBM data centre.

Cost reduction
As we continue to build a simpler, more efficient bank, we have made further progress with cost reduction initiatives. Operating costs fell to £222.8m in H1 2016 from £262.9m in H1 2015, representing a 15.3% decrease, driven by the rationalisation of our branch network, continued reduction of staffing levels and the impact of digital development.

The continuing decline in branch transactions is indicative of the changing behaviour of our customers. As a result, the 54 branch closures announced in January 2016 were completed by the end of June 2016, and we plan to close a further five by the end of the year. Our branch network remains an important part of our multi-channel service but we continue to review the level of usage as customer behaviour changes.

Projects
The first half of 2016 has seen a greater than planned level of strategic and remediation project spend as a number of larger programmes are at key phases in their delivery, the most material being the outsourcing of our IT infrastructure to IBM, the development of our digital channels and the outsourcing of our mortgage processing. With a number of projects having concluded or nearing completion, we do not anticipate a similar level of spend in the second half of the year. However, the transformation component of our mortgage outsourcing contract in particular faces some issues that could impact its overall cost.

People
As the Chairman has said, we have focused heavily on Executive succession in the first half of 2016. Liam Coleman's appointment as Deputy Chief Executive Officer on 3 May 2016 enables an orderly succession and handover as he takes on the CEO role when my contract with the Bank comes to an end on 31 December 2016. John Worth joins the Bank as Chief Financial Officer in September 2016 replacing John Baines, subject to regulatory approval, and Steven Pickering has been appointed Chief Risk Officer effective from 8 August 2016. We have also secured the services of a new Human Resources Director, again subject to regulatory approval. We have thus delivered in the key area of Executive succession and I am pleased with the outcomes achieved.

In addition, Grahame McGirr, Managing Director for the Non-core business will also leave in due course in recognition of the fact that a significant portion of the required deleverage of Non-core assets has already taken place. I would like to take this opportunity to formally recognise the substantial contributions that John, Grahame and Julie Harding, our HRD, have made to the Bank both in the early stages of recapitalisation and with the subsequent turnaround efforts over the last three years.

Given our current inability to make variable payments to our colleagues, I am pleased that we have agreed and announced a fixed payment structure for the bulk of our colleagues. We are still considering a number of options for our more senior people. We hope to resolve this by the end of the third quarter so that we remain competitive and are able to attract and retain talented colleagues.

Summary
The underlying trend in the Core Bank is encouraging. Whilst there is still considerable work to be done, this reinforces the potential for a sustainable and secure Retail and SME Bank which is differentiated by values and ethics. We continue to have a considerable transformation portfolio to deliver. An important element of this is the continued progress outsourcing our IT infrastructure to IBM. We expect further significant progress on this towards the year end and we are engaging with the FCA to agree the point at which in their view we will no longer be in breach of the threshold condition in this area.

We remain focused on executing our Updated Plan for the long term benefit of all stakeholders albeit this has become more difficult given the uncertain macroeconomic environment following the EU referendum result, which is challenging for all banks.

Despite these challenges, much has been achieved in de-risking the Bank and it continues to strengthen in important areas, particularly around Risk, IT, senior executive succession and ensuring good outcomes for customers. It is clear that we have a Bank that is valued by our customers. Much of the work to rid the Bank of the legacy issues has been done but challenges remain. I am grateful for the support of colleagues, customers, regulators and shareholders as we continue this journey of transformation.

Niall Booker
Chief Executive Officer
17 August 2016

DETAILED FINANCIAL REVIEW

Capital
As anticipated in the Bank's Updated Plan, accepted by the PRA, the Bank's capital ratios have deteriorated owing to the continued losses which have eroded capital resources; these have not been offset by the similar levels of RWAs reduction seen in prior periods. Total RWAs have reduced by £0.2bn, with increases in Core RWAs of £0.5bn more than offset by Non-core RWA reductions of £0.7bn.

All figures quoted below are reporting on a Capital Requirements Directive (CRD IV) basis.

The Bank's Common Equity Tier 1 (CET1) capital resources have decreased by £0.2bn in the period to £1.0bn, primarily as a result of the £132.1m statutory loss after tax for the half year.

Non-core RWAs have reduced by £0.7bn, driven mainly by a transfer of Corporate CoAM assets to BaCB, and continued deleverage of the Corporate CoAM portfolio. The Bank continues to monitor its ability to undertake any further securitisations of the Optimum portfolio. It remains a closed book and a £0.1bn reduction in RWAs has been seen.

Total Core RWAs which includes Core Credit Risk and Operational Risk RWAs have increased to £5.2bn (31 December 2015: £4.7m). Core Credit Risk RWAs have increased by £0.7bn, primarily driven by the transfer of business from Corporate CoAM described above coupled with an overall increase in the mortgage portfolio. Operational Risk RWAs have decreased by £0.2bn following the annual recalculation of the Pillar 1 operational risk requirement subsequent to the 2015 year end results.

As outlined in detail in the Bank's 2015 Annual Report and Accounts the Bank is seeking to enhance its credit modelling capability in a number of key portfolios and is in discussion with the PRA with regards to the approval and implementation of these enhancements, this is discussed further within the Principal Risks and Uncertainties section.

A major element of these enhancements relates to how the Bank determines Loss Given Default (LGD) and Probability of Default (PD) for retail secured mortgages. The Bank continues to include a £0.3bn temporary RWA adjustment in relation to the anticipated impact on RWAs once these models go live. For more information please refer to the Bank's 2015 Annual Report and Accounts. The Bank has not changed the £0.3bn temporary RWA adjustment in the first six months of 2016.

The movements outlined above are the primary factors resulting in the Bank's CRD IV CET1 ratio decreasing by 2.1% from 15.5% to 13.4%.

The Bank's total capital ratio stands at 19.7% as at 30 June 2016 (31 December 2015: 21.6%) relative to a regulatory minimum of 8.0%.

The Bank's leverage ratio is 3.4%, down 0.4% from 31 December 2015 reflecting the ongoing balance sheet deleveraging activity being offset by the reduction in CET1 capital driven by the statutory loss in the period.

CRD IV capital position

	As at 30 June 2016	As at 31 December 2015	Change
Capital Ratio			
CET1 ratio	**13.4%**	15.5%	(2.1%)
Total capital	**19.7%**	21.6%	(1.9%)
RWAs (£bn)	**7.2**	7.4	(0.2)
Leverage ratio	**3.4%**	3.8%	(0.4%)

ICG and PRA Buffer compliance

As at 30 June 2016, the Bank was not compliant with its Individual Capital Guidance (ICG), being the PRA's statement as to the regulatory capital (Pillar 2a) it expects the Bank to hold. However, a deficit was anticipated within the Bank's Updated Plan. As at 30 June 2016, the Bank's Pillar 2a requirement was set at 12.0% of RWAs or £864m, of which 6.7% must be met by CET1. This has increased from December 2015 as a result of an additional CRR related Pillar 2a capital requirement as outlined in the 2015 Annual Report and Accounts.

Maximum distributable amount

The Bank does not currently meet its ICG and Combined Buffer. As noted in the 2015 Annual Report and Accounts, under the PRA rulebook, not meeting the Combined Buffer prevents the Bank from creating an obligation to pay variable remuneration during the period of non-compliance. To remain competitive and to enable the attraction and retention of employees, the Bank has agreed a fixed payment structure for the bulk of employees which has increased costs.

Liquidity

Overview

The Bank raises the majority of its funding through accepting Retail and commercial deposits. The Bank also maintains a range of funding programmes targeting wholesale investors.

The focus of the funding and liquidity strategy of the Bank has been to:

- reduce Retail deposits to match the reduction of balance sheet assets and reduce the cost of the liability base;
- ensure the availability of an appropriate level of unencumbered high quality liquid assets (HQLA) to meet internal and regulatory requirements;
- maintain the availability of mortgage collateral to support the secondary liquidity position; and
- repay wholesale funding to manage the balance sheet and the Bank's liquidity position.

Credit rating

On 31 July 2015, Moody's announced that the Bank's senior unsecured rating remains unchanged at Caa2 but now has a positive outlook. Moody's upgraded the Bank's Baseline Credit Assessment (BCA) from Ca to Caa2. However, Moody's removed any government support assumption leaving the overall rating unchanged at Caa2. Fitch confirmed the Bank's ratings at B in November 2015, but revised the outlook to stable from negative. The current ratings are:

	Long term	Short term
Moody's	Caa2	NP
Fitch	B	B

The Bank's current credit ratings continue to result in:

- sub-investment grade ratings on the Bank's senior debt, in turn leading to a significant reduction in the demand for these types of instrument;
- a negative impact on the Bank's ability to access short term unsecured wholesale funding; and
- heightened collateral requirements within some clearing systems.

Liquidity portfolio

	As at 30 June 2016 £m	Restated As at 31 December 2015 £m	Change £m
Operational balances with central banks	**2,056.6**	2,329.3	(272.7)
Gilts	**949.6**	1,450.2	(500.6)
Central government and multilateral development bank bonds	**587.1**	760.2	(173.1)
Total primary liquidity	**3,593.3**	**4,539.7**	**(946.4)**
Total secondary liquidity	**5,274.8**	**5,707.4**	**(432.6)**
Total liquidity	**8,868.1**	**10,247.1**	**(1,379.0)**

The Bank's liquidity resources, as at 30 June 2016, were £8.9bn compared to £10.2bn as at 31 December 2015. As at 30 June 2016 the liquid asset ratio was 12.7% (31 December 2015: 15.6%). This is in line with what we expected as per the Updated Plan, as the Bank brings its liquidity position in line with the rest of the industry. Primary liquidity consists of liquid assets that are eligible under European Banking Authority (EBA) regulations (high quality liquid assets).

Secondary liquidity comprises of liquid investment securities not included as part of primary liquidity as well as other forms of contingent liquidity sources. In the 2015 Annual Report and Accounts contingent liquidity included all other non-primary liquid assets. The Bank has now narrowed this definition in the statutory accounts to only include assets (excluding other liquid assets) eligible for central bank facilities and therefore the 2015 comparatives have been restated to align with this change.

Primary liquidity has decreased over the period by £0.9bn and secondary liquidity has decreased by £0.4bn.

Retail and commercial funding

The majority of the Bank's funding comes from Retail and commercial accounts. As at 30 June 2016, customer deposits were £22.1bn compared to £22.8bn as at 31 December 2015.

Retail deposits reduced over the period by £0.7bn. The Bank's strategy is to reduce its Retail deposits to match the reduction in the balance sheet and to reduce the cost of liabilities. The reduction in deposits in the period has slowed versus 2015 as the Bank's deleverage activity has reduced.

The total amount of corporate deposits reduced by £0.1bn over the period. This was due to the planned reduction in Non-core liability balances.

	As at 30 June 2016 £m	As at 31 December 2015 £m	Change £m
Current accounts			
Retail	**3,958.1**	3,808.3	149.8
Corporate	**2,052.0**	2,106.6	(54.6)
Total current accounts	**6,010.1**	**5,914.9**	**95.2**
Instant access savings accounts			
Retail	**6,173.9**	6,580.6	(406.7)
Corporate	**490.2**	486.1	4.1
Total instant access saving accounts	**6,664.1**	**7,066.7**	**(402.6)**
Term deposits and bonds			
Retail	**3,972.4**	4,277.3	(304.9)
Corporate	**254.6**	281.4	(26.8)
Total term deposits and bonds	**4,227.0**	**4,558.7**	**(331.7)**
Individual savings accounts (ISA)			
Retail – ISA Fixed	**2,451.5**	2,355.9	95.6
Retail – ISA Demand	**2,419.5**	2,622.6	(203.1)
Total ISA accounts	**4,871.0**	**4,978.5**	**(107.5)**
Other deposits	**313.2**	290.6	22.6
Total customer deposits	**22,085.4**	**22,809.4**	**(724.0)**

Wholesale funding
The Bank uses wholesale funding to supplement Retail and Corporate CoAM customer deposits by raising debt to diversify funding sources. The Bank has a variety of wholesale funding sources outstanding, including securitisations, covered bonds, unsecured notes, bi-lateral facilities, and repurchase agreements.

The repayment of the final £150.0m FLS drawing was made in January 2016.

	As at 30 June 2016 £m	As at 31 December 2015 £m	Change £m
Preference shares, PSBs and subordinated debt	**468.2**	457.0	11.2
Secured funding	**1,820.3**	2,091.0	(270.7)
Repos	**638.6**	671.3	(32.7)
Market borrowing	**1.6**	10.9	(9.3)
MTNs	**405.0**	404.9	0.1
Total wholesale funding	**3,333.7**	**3,635.1**	**(301.4)**

Figures are based on nominal values and accrued interest as at 30 June 2016 and 31 December 2015.

The table below analyses contractual maturities (as opposed to internally expected repayment dates), with the Leek notes and Silk Road 3 being disclosed based on call dates:

	As at 30 June 2016 £m	As at 31 December 2015 £m	Change £m
Repayable in less than 1 month	**525.1**	522.5	2.6
Repayable between 1 and 3 months	**203.7**	159.7	44.0
Repayable between 3 and 6 months	**483.8**	352.4	131.4
Repayable between 6 and 9 months	**-**	243.3	(243.3)
Repayable between 9 and 12 months	**493.6**	433.0	60.6
Repayable between 1 and 2 years	**424.2**	746.9	(322.7)
Repayable between 2 and 5 years	**269.8**	259.0	10.8
Repayable in more than 5 years	**933.5**	918.3	15.2
Total external funding	**3,333.7**	**3,635.1**	**(301.4)**

Revised basis of preparation
As outlined in the Bank's 2015 Annual Report and Accounts the results presented in the following section are on a management accounts basis

and are representative of how the Bank was managed in H1 2016.

Please refer to the 2015 Annual Report and Accounts for details on the presentational changes and the rationale. The following table provides a reconciliation of the cost analysis in the Interim Financial Report 2015 to that re-presented in the Interim Financial Report 2016.

June 2015 cost reclassification	Prior basis £m	Reclass project depreciation £m	Operating costs reclassification £m	Project category reclassification £m	Reclass FSCS levy £m	Current basis £m
Total direct costs	96.6	(3.8)	(12.0)	-	-	80.8
Operations and head office overheads	163.0	(13.4)	12.0	-	20.5	182.1
Total operating costs	259.6	(17.2)	-	-	20.5	262.9
Operating projects	21.5	11.7	-	(5.2)	-	28.0
Remediation projects	40.5	1.8	-	3.1	-	45.4
Strategic projects	39.9	3.7	-	(4.3)	-	39.3
Severance	-	-	-	6.4	-	6.4
Total project expenditure	101.9	17.2	-	-	-	119.1
FSCS levy	20.5	-	-	-	(20.5)	-
Total Costs	382.0	-	-	-	-	382.0

In addition, £10.6m of net interest income, in H1 2015, has been reallocated from the Retail business segment to the Treasury business segment. This relates to income generated from hedging the Bank's free reserves.

Total Bank financial performance

Bank performance

	30 June 2016 £m	Re-presented[4] 30 June 2015 £m	Change £m
Net interest income	**201.5**	233.6	(32.1)
Losses on asset sales	**(11.6)**	(38.2)	26.6
Non-interest income	**38.3**	41.1	(2.8)
Operating income	**228.2**	236.5	(8.3)
Operating expenditure	**(222.8)**	(262.9)	40.1
Operational project expenditure	**(19.7)**	(28.0)	8.3
Impairment gains on loans and advances	**11.6**	44.6	(33.0)
Operating result	**(2.7)**	(9.8)	7.1
Remediation project expenditure	**(71.3)**	(45.4)	(25.9)
Strategic project expenditure	**(34.7)**	(39.3)	4.6
Severance	**(8.5)**	(6.4)	(2.1)
Sale of Visa Europe share[2]	**58.1**	-	58.1
Share of post-tax profits from joint ventures	**0.4**	-	0.4
Conduct/legal risk	**(21.1)**	(49.0)	27.9
Fair value amortisation	**(97.2)**	(54.3)	(42.9)
Loss before taxation	**(177.0)**	(204.2)	27.2
Net interest margin[3]	**1.42%**	1.32%	0.10%
Cost:income ratio[1]	**101.1%**	105.9%	4.8%

1. Operating expenditure and operating projects (including associated depreciation and amortisation) divided by operating income excluding losses on asset sales.
2. Net of a £3.3m foreign exchange loss.
3. Net interest margin is calculated as net interest income divided by the average of the opening and closing asset balances for the period.
4. The 2016 operating and project expenditure are now presented on the current basis as per the revised basis of preparation reconciliation.

The 2016 interim financial results reflect the continued progress made in delivering against the areas of focus outlined in the Bank's Updated Plan. The Bank has continued to deliver a significant reduction in operating expenditure, down £40.1m period on period, continuing to reflect the progress of cost reduction initiatives. The main reductions in costs are as a result of the continued focus on improving efficiency and simplification of Bank processes and are primarily attributable to the reduction in operating staff costs of £24.3m and the recurring benefit from 2015 initiatives such as the Branch network rationalisation, FTE (full time equivalents) reductions and costs associated with Unity Trust Bank, which are no longer consolidated into the Bank's results.

The Bank's cost of funding has fallen period on period as a result of its repricing activity in 2015, with further managed customer deposit reduction in the first half of 2016.

Non-interest income has reduced marginally relative to the prior year. Underlying non-interest income has fallen predominantly within the Retail business, driven by a reduction in Link commission fees following the disposal of the majority of the ATM estate completed in June 2015 and lower overdraft fees following the launch of the new overdraft proposition in April 2015. Revised merchant interchange rates have further reduced non-interest income. These reductions are partially offset by a one-off gain in H1 2016 following the sale of part of the gilt portfolio.

Losses on asset sales have reduced to £11.6m, following a planned period on period reduction in the level of Non-core deleverage.

The Bank has continued its significant investment activities in H1 2016 with total revenue expenditure of £125.7m to progress the transformation of IT resilience, remediation of systems and processes and to simplify products. Furthermore, the Bank has continued to commit investment into the digital channels resulting in upgrades to the online banking website and new digital product offerings.

Investment continues across all project categories to transform the Core Bank's operations and to rebuild the Core Bank. Despite the progress made, overall investment will continue into 2017 as anticipated in the Updated Plan.

The Bank's financial performance continued to be impacted by legacy issues, particularly the fair value unwind related to the merger with Britannia Building Society of £97.2m, which is accelerating as a result of the remaining liabilities approaching expected maturity. Conduct/legal risk charges totalled £21.1m in the period, being a decrease of £27.9m on H1 2015, as the Bank continues to progress the redress and remediation programme.

The Bank's statutory loss before taxation for H1 2016 is £177.0m.The figures referenced and presented on these pages are on a management accounts basis. A reconciliation of these numbers to the statutory accounts is provided in the segmental information in note 3.

Operating expenditure

	30 June 2016 **£m**	Re-presented 30 June 2015 £m	Change £m
Core direct costs	**61.9**	75.1	(13.2)
Non-core direct costs	**4.6**	5.7	(1.1)
Total direct costs	**66.5**	80.8	(14.3)
Operations and head office overheads	**156.3**	182.1	(25.8)
Total operating costs	**222.8**	262.9	(40.1)
Of which: staff costs	**97.5**	121.8	(24.3)

Total operating expenditure reduced by £40.1m from £262.9m to £222.8m.

Core direct costs
The key drivers of the £13.2m reduction are the on-going savings of the 2015 branch rationalisation programme and other cost saving initiatives which have delivered savings of £5.4m. This is in line with the Core Bank strategy of a shift to digital for new and existing customers. £0.8m of the reduction is driven by a difference in the phasing of marketing spend.

Unity Trust Bank is now regarded as an investment rather than fully consolidated, which has contributed a further £5.2m of reduction period on period.

Non-core direct costs
Continued focus on deleveraging of the Non-core portfolio has driven savings of £1.1m with a significant element of this reduction due to lower staff costs.

Operations and head office overheads
Operational cost savings have been primarily driven by the 2015 initiatives including ATM rationalisation, process improvement and paper correspondence reduction. These activities combined with further efficiency savings and lower processing costs (due to the reduced branch network) have resulted in headcount falling by 930 full time equivalents.

The FSCS levy was £14.3m lower period on period as the Bank was not subject to the payment of the capital levy element in the first half of 2016.

FTEs
At a total Bank level, operating staff costs have reduced by £24.3m to £97.5m. Permanent staff numbers (full time equivalents) have fallen by 1,292 to 4,210 with direct pay falling by £19.4m. In addition the number of short to medium term specialist contractors have halved from 348 to 174. As a result contractor costs have fallen by £4.9m to £8.0m. Note these exclude any FTE and associated expense relating to the Bank's project expenditure.

Project expenditure

	30 June 2016	30 June 2015	Change

	£m	£m	£m
Operational projects expenditure	**12.2**	16.4	(4.2)
Operational projects depreciation	**7.5**	11.6	(4.1)
Operational projects	**19.7**	28.0	(8.3)
Remediation projects expenditure	**68.2**	43.6	24.6
Remediation projects depreciation	**3.1**	1.8	1.3
Remediation projects	**71.3**	45.4	25.9
Strategic projects expenditure	**33.0**	35.5	(2.5)
Strategic projects depreciation	**1.7**	3.8	(2.1)
Strategic projects	**34.7**	39.3	(4.6)
Severance	**8.5**	6.4	2.1

Operational projects
Operational projects relate to changes in the regulatory environment and smaller business led initiatives, including process improvements.

The charge for the period to 30 June 2016 was £19.7m (H1 2015: £28.0m) of which £7.5m (H1 2015: £11.6m) relates to depreciation of previous investments. Key current projects include: Cheque Imaging (£4.5m); EU Mortgage Directive (£0.8m); EU Payment Account Directive (£1.4m); Customer Complaints Handling & Reporting (£1.6m) and £3.9m on other smaller projects, ensuring regulatory and mandatory requirements of the Bank are met. 2015 included investment on the Regulatory Reporting Programme which was completed in H2 2015 (£4.6m) and therefore a non-recurring expense in 2016.

Depreciation has reduced by £4.1m due to the transfer of shared assets to The Co-operative Group as part of separation.

Remediation projects
Remediation projects relate to IT remediation and resiliency as well as activity associated with Bank separation.

The H1 2016 cost of £71.3m (H1 2015: £45.4m) includes depreciation of £3.1m (H1 2015: £1.8m). Key projects include: Enterprise Services (ES) outsourcing and separation from The Co-operative Group has expenditure of £74.8m in 2016, partially offset by £35.8m utilisation of 2014 provision resulting in a net charge for the period of £39.0m; Core IT (£7.1m), Data and Reporting (£10.9m) and other smaller projects (£11.2m) for ongoing remediation issues identified.

The key driver for the increased costs against 2015 is due to increased spend on ES of £27.4m net of provisions.

Strategic projects
Strategic projects relate to those projects that are transformational in nature and deliver significant cost or income benefits to the business. Project costs of £34.7m (H1 2015: £39.3m), including depreciation of £1.7m (H1 2015: £3.8m), reflect continued investment to enhance capability across the organisation. Projects included: further branch transformation, with closure of an additional 54 branches in 2016 (£9.9m), mortgage outsourcing (£3.7m), digital (£9.1m), loans outsourcing (£5.6m) and the completion of other projects (£4.7m).

Severance
The H1 2016 costs of organisational design changes are £8.5m. This is higher than H1 2015 (£6.4m) but is as expected in the Updated Plan in order to implement the Bank's target operating model.

All categories included permanent, contract or temporary resource costs working on these projects within the Bank.

Capital expenditure

	30 June 2016 £m	Re-presented 30 June 2015 £m	Change £m
Operational projects	2.4	(0.8)	3.2
Remediation projects	0.3	(4.2)	4.5
Strategic projects	(17.1)	(16.4)	(0.7)
Total project capital expenditure	**(14.4)**	**(21.4)**	**7.0**

The above capital table does not include other balance sheet items relating to the mortgage outsourcing finance lease (£6.5m).

Operational projects capital expenditure release in H1 2016 relates mainly to the cheque imaging intangible asset impairment and the associated write-off costs due to a change in the Bank's expected future solution.

There has been no remediation capital expenditure in H1 2016; H1 2015 was driven by finance transformation software license spend (£4.1m).

Strategic capital expenditure in 2016 includes the digital programme costs of £11.4m (H1 2015: £15.3m) and additional capital spend relating to Mortgage outsourcing.

Impairment gains and losses

	30 June 2016 £m	30 June 2015 £m	Change £m
Core impairment gains/(losses)	**2.5**	(2.7)	5.2
Non-core impairment gains	**9.1**	47.3	(38.2)
Net impairment gains on loans and advances	**11.6**	44.6	(33.0)

Net impairment write-backs of £11.6m in H1 2016 compares to £44.6m of net impairment write-backs in H1 2015.

Non-core net impairment write-back in H1 2016 of £9.1m is £38.2m lower than in the same period last year. H1 2015 saw significant net impairment write-backs driven by assets being disposed or revalued at favourable prices to the net book value resulting in the write-back of previously recognised impairment provisions. Lower levels of deleverage in H1 2016 coupled with cases moving into default have significantly reduced these benefits.

H1 2016 impairment also benefited from a one-off £9.5m write-back following the restructure of a syndicated loan within the Corporate CoAM portfolio. This is offset by a charge of £8.6m within other operating income in line with the accounting treatment for the derecognition of the original loan and recognition of a new loan at fair value.

Core net impairment write-backs of £2.5m are driven mainly by the Retail business segment which has experienced impairment write-backs of £3.3m in the period.

A more detailed analysis of impairments is provided in the Risk Management section.

Conduct and legal risk

Conduct and legal risk charges

	30 June 2016 £m	30 June 2015 £m	Change £m
CCA Customer Redress	**11.2**	(20.0)	31.2
CCA Cost to Remediate	**(0.5)**	(9.9)	9.4
PPI Redress	**(28.7)**	-	(28.7)
PPI Cost to Remediate	**(4.8)**	-	(4.8)
Packaged Accounts	**-**	(16.8)	16.8
Mortgages	**0.9**	(3.9)	4.8
Legal	**0.4**	0.5	(0.1)
Other	**0.4**	1.1	(0.7)
Total	**(21.1)**	(49.0)	27.9

The H1 2016 charges relating to conduct and legal risk were £21.1m (30 June 2015: £49.0m).

The £21.1m charge primarily comprised an increase for PPI of £33.5m which reflects the Bank's initial assessment of the impact of the FCA Consultation Paper CP16/20 published on 2 August 2016. The Bank has provided for an additional 12 month period recognising the revised time bar end date of 30 June 2019. This accounts for £18.4m of the PPI Redress provision increase and £4.8m of the delivery cost increase. The Bank is required to continually learn from customer experience, regulatory guidance and Financial Ombudsman Service feedback and following a routine regulatory review has made minor revisions to certain complaint handling policies going forward which result in a further £11.2m of provision being raised for customer redress and £0.5m for delivery costs.

As at the reporting date the Bank had completed over 95% of the required remediation for non-compliance with the technical provisions of the CCA. The 30 June 2016 CCA provisions includes a £10.7m net release following a detailed review of the remaining cases that require redress and remediation.

Current mortgage remediation activities were substantially progressed in H1 2016 and the existing mortgage programme was 91% complete at the reporting date. Work to address these in-scope conduct issues is on schedule and will be materially complete by year end.

Business segment financial performance

	30 June 2016	Re-presented 30 June 2015	Change
	£m	£m	£m
Retail contribution	**133.7**	156.9	(23.2)
BaCB contribution	**28.3**	21.8	6.5
Core contribution excluding Treasury/other	**162.0**	178.7	(16.7)
Treasury/other contribution	**31.1**	5.2	25.9
Core contribution result	**193.1**	183.9	9.2
Non-core contribution result	**(19.8)**	16.4	(36.2)
Head office overheads	**(156.3)**	(182.1)	25.8
Operational project costs	**(19.7)**	(28.0)	8.3
Operating result	**(2.7)**	(9.8)	7.1

Contribution is defined as net income after impairment and direct costs. Head office overheads (costs incurred in central functions) are not allocated to a business segment.

Core contribution excluding Treasury/other contribution is down period on period at £162.0m (30 June 2015: £178.7m) as a result of falling Retail non-interest income and net interest income as outlined in the below sections.

Treasury/other improved by £25.9m primarily driven by a one-off gain following part of the gilt portfolio being sold.

Non-core contribution generated a loss of £19.8m (30 June 2015: profit of £16.4m). The primary driver of this deterioration is the deleverage strategy resulting in an underlying reduction in net interest income and reduced impairment write-backs partially offset by lower losses on asset sales.

These are discussed in more detail in the following sections.

Internal transfer pricing policy
Period on period business segment net interest income is affected by the Bank's internal transfer pricing policy.

The Bank's internal transfer pricing policy is designed to compensate liability balances for providing the funding used by the Bank to support and/or grow its asset base, which is then charged for using this funding.

The Bank calculates a rate to charge all of the Bank's assets and compensate all of the Bank's liabilities based on its cost of funding over time. The rate applied to individual asset or liability balances is based on expected duration assumptions for each balance.

These charges and compensation amounts are included within each business segment's net interest income.

Therefore, the total volume of assets and liabilities within each business segment has a significant impact on the net amount of transfer pricing it is charged or compensated for across the business segments.

The Retail and BaCB portfolios have more liabilities than assets, and therefore they generate a net income from internal transfer pricing. The Non-core portfolio is funded by these net liability positions and therefore receives an overall transfer pricing charge.

Treasury manages the charging and compensation of transfer pricing across the business segments and due to the underlying asset and liability duration mismatch, records the net position within its interest income.

The Bank's cost of funding is updated annually and results in changes to the rates which Core assets are charged and the rates which Core liabilities are compensated between periods.

The Bank's cost of funding has reduced between 2015 and 2016, predominantly as a result of the reduction in retail liability pricing. This means Core assets are charged a lower transfer pricing rate and Core liabilities are compensated with a lower transfer pricing rate.

Core

Core contribution

	30 June 2016 £m	Re-presented 30 June 2015 £m	Change £m
Net interest income	**210.5**	231.3	(20.8)
Gains/(losses) on asset sales	**0.5**	(0.1)	0.6
Non-interest income	**41.5**	30.5	11.0
Net income	**252.5**	261.7	(9.2)
Direct costs	**(61.9)**	(75.1)	13.2
Impairment gains/(losses) on loans and advances	**2.5**	(2.7)	5.2
Contribution result	**193.1**	183.9	9.2
Head office overheads	**(156.3)**	(182.1)	25.8
Operational projects	**(19.7)**	(28.0)	8.3
Operating result	**17.1**	(26.2)	43.3
Net interest margin[1]	**1.82%**	1.83%	(0.01%)

	As at 30 June 2016 £m	As at 31 December 2015 £m	Change £m
Assets	**23,134.5**	23,316.2	(181.7)
Liabilities	**26,132.0**	26,581.9	(449.9)

1. Total Core asset and liability net interest income divided by average asset balances for the period.

Core Bank contribution, comprising of Retail, BaCB and Treasury/other, increased by £9.2m.

Retail contribution reduced by £23.2m, due to a reduction in non-interest and interest income. This reduction is partially offset by direct cost savings.

BaCB contribution increased by £6.5m, as a result of the enlarged asset base created by the reclassification of Non-core assets.

H1 2016 net interest income includes a one-off gain of £7.6m which represents prior year subsidiary accounting adjustments.

Treasury/other contribution increased by £25.9m partly as a result of the gain on sale achieved on AFS gilts held as a hedge for the LME subordinated debt issuance. This is partially offset by the fall in net transfer pricing revenue generated within Treasury, following significant changes in the Bank's balance sheet.

These are discussed in more detail in the following sections.

Core net interest margin has reduced relative to the prior period with a NIM of 1.82% (H1 2015: 1.83%). This is inclusive of the £7.6m one-off adjustment outlined above and would have fallen by a further 7bps if this was not included. The Bank has delivered significantly higher volumes of mortgages in H2 2015 and H1 2016 when compared to H1 2015, however it has priced more competitively to do so. This results in an overall reduction in the Bank's asset margin which has been partially offset by improvements in underlying liability margins.

Core assets have remained relatively constant at £23.1bn. There have been movements in the period relating to a fall in Treasury/other assets of £0.9bn which is partially offset by a £0.4bn increase seen in the Retail asset book and reclassification of £0.4bn loans from Corporate CoAM (Non-core) to BaCB (Core).

Core liabilities have decreased from £26.6bn at 31 December 2015 to £26.1bn at 30 June 2016.

Retail contribution

	30 June 2016 £m	Re-presented 30 June 2015 £m	Change £m
Net interest income	**171.1**	194.3	(23.2)
Non-interest income	**14.1**	28.2	(14.1)
Net income	**185.2**	222.5	(37.3)
Direct costs	**(54.8)**	(60.8)	6.0
Impairment gains/(losses) on loans and advances	**3.3**	(4.8)	8.1
Contribution result	**133.7**	156.9	(23.2)

	As at 30 June 2016 £m	As at 31 December 2015 £m	Change £m
Customer assets	**14,540.4**	14,123.2	417.2
Customer liabilities	**19,117.2**	19,754.8	(637.6)

Retail contribution has reduced by £23.2m to £133.7m (30 June 2015: £156.9m). Direct costs have improved by £6.0m which is offset by £23.2m and £14.1m reduction in net interest income and non-interest income respectively.

The Retail business continues to benefit from the increased new business origination activities in the period. Mortgage completions have increased to £1.5bn in the first six months of 2016 compared to £1.1bn in the same period of 2015. Total mortgage redemptions decreased in the period to £0.7bn down from £1.0bn in 2015. The mortgage portfolio, including contractual repayments, had a net increase of £0.4bn from 31 December 2015.

The Bank's current account volumes marginally reduced over the period. The Bank increased its presence within the marketplace through the launch of the Everyday Rewards incentive in the first quarter of 2016, helping improve the Bank's brand positioning and helping maintain the Bank's NPS for Current Accounts. Current account balances have grown £0.2bn during the period.

The overall Retail asset margin has narrowed, driven by the competition and the downward trend on mortgage rates seen in the UK mortgage market over the last year, which has offset some of the additional interest generated from balance sheet growth. Furthermore, the planned lower Retail customer liability balances, which have reduced £0.6bn in the period, have contributed to the fall in net interest income for Retail in H1 2016.

The reduction in net interest income has however been partially offset by the reduction in the level of interest expense paid for Retail customer deposits following the repricing activity taken across 2015.

Retail non-interest income reduced to £14.1m (30 June 2015: £28.2m), primarily due to a reduction in income attributable to the revised policy on overdraft fees, aligned with the Bank's ethical stance. In addition, the planned reduction in the ATM estate and industry-wide impacts of revised merchant interchange fees, have reduced the Bank's card transaction fee income.

The impairment write-back for Retail was £3.3m, primarily within the unsecured loan portfolio driven by the reduction in loan balances.

Business and Commercial Banking (BaCB)

Business and Commercial Banking contribution

	30 June 2016 £m	Re-presented 30 June 2015 £m	Change £m
Net interest income	**26.4**	20.3	6.1
Non-interest income	**6.7**	5.6	1.1
Net income	**33.1**	25.9	7.2
Direct costs	**(4.2)**	(5.1)	0.9
Impairment gains on loans and advances	**(0.6)**	1.0	(1.6)
Contribution result	**28.3**	21.8	6.5

	As at 30 June 2016 £m	Re-presented as at 31 December 2015 £m	Change £m
Customer assets	**884.1**	564.2	319.9
Customer liabilities	**2,691.9**	2,689.2	2.7

The BaCB portfolio contributed £28.3m in H1 2016, a £6.5m increase on prior year.

Customer liabilities have remained flat at £2.7bn, largely as a result of lower levels of organic growth across direct current account products compared to last year.

Customer assets increased from £0.6bn to £0.9bn, mainly due to £350m of loans being reclassified from Non-core to Core (£250m PFI and £100m Renewable Energy) following individual re-assessments by Core Bank Corporate Credit Risk Underwriting (CCRU). Both portfolios had a blended average return on capital above the required threshold for existing customers and were considered to be aligned to the Bank's ethical perspective given the sectors the loans support. These include environmentally friendly energy generation in predominantly community based projects and large social infrastructure projects such as schools and other community projects.

Net interest income increased to £26.4m in H1 2016 from £20.3m. This has primarily been driven by revised hedging policies for non-interest bearing current accounts, additional interest income from its enlarged asset base and liability pricing changes implemented in H2 2015.

Treasury/other business contribution

	30 June 2016	Re-presented 30 June 2015	Change
	£m	£m	£m
Net interest income	**13.0**	16.7	(3.7)
Gain/(losses) on asset sales	**0.5**	(0.1)	0.6
Non-interest income	**20.7**	(3.3)	24.0
Net income	**34.2**	13.3	20.9
Direct costs	**(2.9)**	(9.2)	6.3
Impairment gains on loans and advances	**(0.2)**	1.1	(1.3)
Contribution result	**31.1**	5.2	25.9

	As at 30 June 2016	Re-presented As at 31 December 2015	Change
	£m	£m	£m
Assets	**7,710.0**	8,628.8	(918.8)
Liabilities	**4,322.9**	4,137.9	185.0

Treasury/other contributed £31.1m for H1 2016 compared to a contribution of £5.2m for the same period in 2015.

Net interest income fell from £16.7m in H1 2015 to £13.0m in H1 2016. This is primarily due to a fall of £17.0m from internal transfer pricing revenue generated within Treasury, as the central funding business segment, resulting from changes in the Bank's overall balance sheet composition. Interest income from increased cash balances and external derivative hedges partially offset this loss.

In addition to the positive income from higher cash balances and external hedging, higher interest income from Treasury investment assets further reduced the negative impact of reduced transfer pricing income, mainly due to the investment of £1.7bn in Warwick Finance One and Warwick Finance Two asset backed securities.

H1 2016 net interest income includes a one-off gain of £7.6m which represents prior year subsidiary accounting adjustments.

Non-interest income was £20.7m in H1 2016 compared to a cost of £3.3m in H1 2015.

The increase in non-interest income was mainly due to a gain of £15.9m on the sale of AFS gilts held as a hedge for the LME subordinated debt issuance. The LME subordinated debt is now hedged with derivatives. In addition the Bank ended its participation in the Funding for Lending scheme (final repayment was made in January 2016) and therefore did not incur the same fees as in H1 2015.

The Bank also sold £100.0m of the retained Warwick RMBS holdings in May 2016 which contributed £0.5m gain on asset sale.

Non-core

Non-core balance sheet

	30 June 2016	Re-presented 31 December 2015	Change
	£m	£m	£m
Corporate CoAM	**1,332.7**	2,034.3	(701.6)
Optimum	**2,942.4**	3,109.8	(167.4)
Assets	**4,275.1**	5,144.1	(869.0)
Corporate CoAM	**162.2**	282.7	(120.5)
Liabilities	**162.2**	282.7	(120.5)

	As at 30 June 2016	Re-presented As at 31 December 2015	Change
	£m	£m	£m
Customer assets	**4,066.6**	4,898.9	(832.3)
Customer liabilities	**162.2**	282.7	(120.5)

Non-core total assets decreased from £5.1bn to £4.3bn in H1 2016. The level of deleverage of Non-core assets period on period has reduced significantly following the changes in strategy relating to the Optimum portfolio outlined in the Bank's 2015 Annual Report and Accounts. However, the Bank has continued to dispose of Corporate CoAM assets in H1 2016, resulting in a net reduction of £0.8bn of customer assets.

This reduction includes £350m of loans transferred to the Core Bank. For more details see the BaCB section above. The remaining deleverage is driven by the sale of loans to third parties and the re-banking of customers.

The Bank's Non-core residential mortgage portfolio reduced from £3.1bn to £2.9bn in H1 2016, driven by customer capital repayments.

Non-core liabilities have reduced from £282.7m to £162.2m in line with expectations. As the Bank continues its Non-core deleveraging strategy, customers have continued to migrate to other financial institutions.

Non-core contribution

	30 June 2016	Re-presented 30 June 2015	Change
	£m	£m	£m
Net interest income	**(9.0)**	2.3	(11.3)
Losses on asset sales	**(12.1)**	(38.1)	26.0
Non-interest income	**(3.2)**	10.6	(13.8)
Net income	**(24.3)**	(25.2)	0.9
Direct costs	**(4.6)**	(5.7)	1.1
Impairment gains on loans and advances	**9.1**	47.3	(38.2)
Contribution result	**(19.8)**	16.4	(36.2)

Non-core contributed a loss of £19.8m in H1 2016, which is a significant but expected reduction from the positive contribution of £16.4m in H1 2015.

Non-core net interest income has decreased by £11.3m, following the significant reduction in interest generating assets reflecting the significant deleverage delivered.

The reduction in Non-core contribution is further impacted by lower net impairment write-backs on loans and advances in H1 2016 of £9.1m down from a net write-back of £47.3m in H1 2015. The significant net write-back in H1 2015 was driven by assets being disposed or revalued at favourable prices to their net book value resulting in the write-back of previously recognised impairment provisions.

The H1 2016 Non-core loss on sale of £12.1m is £26.0m lower than H1 2015 due to lower volumes of Corporate CoAM deleverage and no further Optimum sales.

Non-core non-interest income is down on prior period as a result of lower asset balances across the business and will continue to fall as the Bank continues to deleverage its asset base.

Direct costs reduced by £1.1m to £4.6m in H1 2016, primarily as a result of a reduction in staff costs, with significantly fewer staff being required as the book is deleveraged.

EU referendum result and outlook

The result of the EU referendum creates uncertainty both in terms of economic and political outcomes and both the level and timing of future capital generation. The overarching strategy remains as per the Updated Plan and the Bank still expects to remain capital generative in the longer term.

As with all UK retail focused banks, the ability to improve net interest margin is significantly reduced in a lower for longer or reducing Base rate environment, the likelihood of which is more apparent following the EU referendum. This directly impacts the Bank's ability to generate sustainable profits in the quantum previously anticipated. The Bank believes that certain markets in which it operates could potentially grow at a lower rate than previously anticipated within the Updated Plan. This would impact the Bank's ability to generate the assets assumed within the Updated Plan and downward revisions have been made to anticipated sales volumes in certain product lines.

Similarly weaker outlooks for a number of other macroeconomic variables, including unemployment, house prices and commercial real estate prices, are likely to adversely impact the Bank's capital requirements compared to those expected within the Updated Plan.

The Bank remains focused on delivering sustainable cost reduction initiatives, resulting from continued project investment in the short term. This will result in the Bank continuing to generate an overall loss before tax in 2016 and 2017.

It is expected that the Bank will meet ICG by the end of the planning horizon, but with less headroom against the expectation within the Updated Plan. Given the macroeconomic uncertainty following the EU referendum, the Bank cannot conclude on whether its expected ICG surplus at the end of the Plan would be sufficient to result in a surplus position to the in force PRA buffer at that time.

The Bank anticipates its CET1%, Tier 1% and Total Capital % will remain above regulatory minima at all times.

The Bank is mindful of the capital implications of the Bank of England's MREL regime and the increased debt issuance this will drive, for the banking industry in general but also for the Bank. The Bank's Updated Plan incorporates MREL qualifying issuance commencing in 2018 which remains the Board's best view of the earliest time when such issuance may be feasible.

The PRA and the Bank of England continue to indicate their strong preference that the Bank incorporates an earlier profile of MREL issuance than currently contemplated by the Bank, however the Bank believes that the results of the EU referendum may further inhibit the Bank's ability to issue in the short term. The Bank of England has stated that it will consult with the Bank before setting binding requirements, which it will be able to do at any point following publication of its MREL policy (expected in H2 2016).

The statements above should be considered in conjunction with those included within the Principal Risks and Uncertainties section.

PRINCIPAL RISKS AND UNCERTAINTIES

This section contains a description of the principal risks and uncertainties facing the Bank and how they are being managed or mitigated. The 'Background' section provides the context in which the Bank's principal risks and uncertainties must be understood. The 'Regulatory Position' section summarises the Bank's deficiencies against regulatory requirements and expectations which constitute principal risks and uncertainties. The third part of this section 'Other Key Risks' outlines the remaining key financial and non-financial risks from the Bank's Risk Management Framework (RMF) and how they are being managed or mitigated.

1. Background

Throughout 2015, a number of external and idiosyncratic opportunities and challenges faced by the Bank drove material changes to the assumptions that were included in the Revised Plan accepted by the PRA in December 2014. These changes impacted the Bank's 2015 performance and resulted in revised assumptions and expectations across the Bank's planning horizon. This resulted in an Updated Plan, for the period 2016-2020, which was approved by the Bank's Board and accepted by the PRA.

The key changes to assumptions included lower for longer Bank of England interest rates, improved Core Bank origination, prevailing market pricing for Non-core deleverage, systemic capital markets volatility, increased 2015 provisions for conduct risks and further clarity around future regulatory capital requirements, including expectations concerning MREL.

In response to these risks the Bank took the strategic decision to halt any further deleverage of the Optimum portfolio and to delay MREL qualifying issuances, as articulated previously in the 2015 Annual Report and Accounts. The Bank will continue to assess this strategy periodically in light of emerging market conditions.

The Bank's ability to deliver the Updated Plan is heavily influenced by external factors which may mean that the underpinning internal assumptions may be incorrect and negatively impact the Bank's performance. Many of these are similar to those faced by other financial institutions, for example, deterioration in general economic conditions, instability of global financial markets (including the effect of macro political conditions in Europe, and more particularly the UK's EU referendum vote in favour of leaving the European Union), the management of credit risk, interest rate risk, currency risk and market risk, as well as risks stemming from regulatory change, increasing regulatory enforcement and an increasingly litigious environment.

2. Regulatory position

The following section summarises the Bank's position in relation to deficiencies against regulatory requirements and expectations. These deficiencies have existed for some time and will continue for some years to come while the Bank implements its Updated Plan. As part of the successful implementation of the Updated Plan, the Bank will need the ongoing support of its Regulators regarding any continuing and intervening deficiencies to required regulatory standards.

2.i Capital

The Bank continues to meet its Pillar 1 capital requirements under normal economic conditions. This is the minimum required under the CRR.

The PRA provides ICG for each bank. This represents guidance on the capital (Pillar 2a) a firm should hold in excess of Pillar 1. As at 30 June 2016, the Bank was not compliant with its ICG for total capital set by the PRA. It is expected that the Bank will meet ICG by the end of the Updated Plan.

The Bank does not currently have sufficient capital resources to withstand a severe stress scenario under its current in force PRA Buffer. The Bank expects to build a buffer by the end of the Updated Plan period, however, with macroeconomic uncertainty following the EU referendum, the Bank cannot conclude on whether its expected ICG surplus at the end of the Updated Plan would be sufficient to result in a surplus position to the in force PRA buffer at that time.

The Bank is mindful of the capital implications of the Bank of England's MREL regime and the increased debt issuance this will drive, for the banking industry in general but also for the Bank. The Bank of England published a consultation paper in December 2015 (CP 44/15) proposing a methodology for setting a firm's individual MREL requirement equivalent to 2 x (Pillar 1 + Pillar 2a) depending on resolution complexity of the individual firm and as specified in the consultation paper the Bank of England may make further amendments to the methodology.

The Bank's Updated Plan incorporates MREL qualifying issuance commencing in 2018 which is the Board's current view of the earliest time when such issuance may be feasible. The PRA and the Bank of England have indicated their strong preference that the Bank incorporates an earlier profile of MREL issuance than currently contemplated by the Bank's Updated Plan. Such expectations have been confirmed by the

Regulators as not intended yet to represent the formal setting of a required MREL issuance plan and the Bank of England has stated that it will consult with the Bank before setting binding requirements, which it will be able to do at any point following publication of its MREL policy (expected to be later in 2016).

Should the Bank be able to issue MREL qualifying instruments earlier than currently considered feasible, then it would do so, which might further delay ICG and PRA buffer compliance and Core Bank operating profitability. The PRA and Bank of England are aware of these possible outcomes. If in due course the Bank becomes subject to a binding requirement to issue MREL and it is unable to do so when required, the Bank's Regulators can agree to accept the Bank's original issuance plan, a revised issuance plan, use their respective powers to require some other remediating action on the part of the Bank or in the absence of any of these the Bank of England may exercise its powers under the Banking Act 2009[1]. As part of the going concern assessment, the Board has taken note of the contents of PRA consultation paper and the Board believes that resolution is less likely than the other outcomes while the Bank is executing its Updated Plan (as accepted by the PRA) and continuing to de-risk the Bank[2].

Both Regulators acknowledge and recognise that any change to the Bank's current planning assumptions for MREL would have to be subject to the overall feasibility of the Bank being able to issue MREL which would need to take into account multiple factors including (without limitation): market conditions, investor appetite, pricing, the Bank's financial performance and plans, and its then existing capital position.

This issue will be kept under close review by the Board, the Bank of England and the PRA periodically over the life of the Updated Plan.

There is no guarantee that the Bank's Regulators will not enforce stricter regulatory capital requirements on the Bank (whether specifically applicable to the Bank or to banks more generally) or that the Bank will not be required to issue additional capital to satisfy MREL.

The PRA published Policy Statement 27/15 to implement the FPC's UK leverage ratio framework in December 2015. This confirms that a 3% minimum leverage ratio requirement plus systemic leverage buffers, where appropriate, applies to firms with retail deposits greater than or equal to £50bn from 1 January 2016 onwards. Therefore, the Bank does not currently have a minimum leverage ratio requirement. The FPC has confirmed that it will review its framework in 2017 with the possibility of extending the framework to all firms from 2018. If a minimum requirement is extended to include the Bank in 2018 it is anticipated that the Bank would not meet these minimum requirements, however, the Updated Plan demonstrates a trend towards a leverage ratio of 3% or greater by the end of the plan.

2.ii Capital Requirements Regulations (CRR)

The Bank is not yet fully compliant with CRR provisions related to the use of an Internal Ratings Based (IRB) approach to modelling its credit risk capital requirements. A review by the PRA took place during 2015 and identified areas of non-compliance and inadequate procedures relating to use by the Bank of an IRB approach requiring improvement and a remediation plan to rectify this under supervisory guidance. These areas include the redesign of model risk policy and model inventory and the strengthening of the overall control environment and governance relating to the IRB approach.

Subsequently, the PRA set the Bank an additional CRR-related Pillar 2a capital requirement in the form of a fixed add-on in order to cover any potential risk in this area. It is the Bank's intention, subject to model enhancements and PRA approval, to have the add-on removed by the end of 2017 at the latest.

A failure to address CRR non-compliance within this timescale could potentially result in further regulatory action such that the Bank's permission to use an IRB approach could be removed, resulting in the use of a standardised approach to modelling credit risk. This could expose the Bank to a material increase in the calculation of its RWAs with a consequent requirement to hold additional capital, the creation of an additional ICG deficit and a reduction in the Bank's CET1 ratio.

2.iii Optimum portfolio Risk Weighted Assets temporary adjustment

The Bank is seeking to enhance its credit modelling capability in a number of key portfolios due to certain inherent weaknesses and to meet PRA requirements. A major element of these enhancements to the existing models relates to how the Bank determines RWAs for retail secured mortgages.

In June 2013 the Bank initially assessed the impact of potential enhancements which drove a £1.0bn increase in the underlying RWAs calculated from the current models. The increase predominantly related to the Optimum portfolio and the £1.0bn adjustment had been included within the Optimum RWAs. This is referred to as a temporary adjustment.

Following the significant deleverage of the Optimum balances in 2015, the Bank judged it appropriate to reduce the temporary adjustment from £1.0bn to £0.3bn in line with the balance reduction in order to ensure that the Optimum RWAs were more reflective of the underlying credit quality of the reduced size of the portfolio. The PRA has not objected to this change. The PRA will review the appropriateness of the add-on on the basis of the Bank's proposed modelling enhancements. Should the PRA not agree to the implementation of the proposed enhancements to the RWA models the Bank may be unable to remove the £0.3bn of the temporary adjustment to the underlying RWAs.

2.iv Technology

Previously, the Bank has reported many shortcomings in its ability to recover its systems in the event of failure in the technical infrastructure. In Q1 2015, the Bank received written confirmation from the FCA that the lack of proven end-to-end disaster recovery capability constituted a breach of the FCA's Threshold Conditions (Threshold Conditions)[3].

Since early 2014 the Bank has driven a programme to build resilience into each component of its critical IT infrastructure, aiming to prove the Bank's ability to recover its critical services in the event of the failure of any individual component. By June 2016 all of the relevant components had been addressed. This component-level proof of recoverability, taken in aggregate, demonstrates a level of recoverability from a major IT infrastructure failure, e.g. the loss of a data centre.

The completion of migration of the Bank's IT Infrastructure to an IBM platform (announced in January 2015) will further improve the Bank's ability to test and demonstrate this recoverability of service.

The FCA is currently reviewing the Bank's position in respect of compliance with the Threshold Condition. It is not yet certain if any further work, beyond that already contemplated, will be required by the FCA before they consider the breach of the Threshold Condition has been remedied and therefore when the Bank may be considered compliant.

The PRA's general policy is not to communicate its assessment of its position in relation to the PRA's Threshold Conditions. However, both the PRA and FCA are closely monitoring the position of the Bank and it remains in continual dialogue with both Regulators.

2.v Risk Management Framework (RMF)

A supervisory review of the Bank's RMF was conducted during 2015 and concluded that further work is required to fully embed the RMF across the Bank. While the Bank's systems of control have improved since 2014 and steps were taken during 2015 to enhance the RMF, further strengthening is required in order to fully and effectively embed the RMF to a consistent standard across the Bank. During 2016 the Bank has been taking substantial steps in this regard. There remain challenges to finalising the implementation of the RMF and the ability to attract and retain staff with the requisite skills and knowledge into the first and second line Risk functions. This continues to be a key priority for the Bank during 2016.

The PRA will continue to closely review the Bank's progress throughout the year. A failure to implement a RMF that addresses any remaining material deficiencies could potentially result in the Regulator taking further action.

3. Other Key Risks

The following pages outline the remaining principal financial and non-financial risks to which the Bank is exposed. The crystallisation of any of these risks could result in an adverse effect on the Bank's business, operating results, financial condition, reputation and prospects. The Bank's RMF categorises these risks and comprises the Board approved segmentation of the risks that the Bank faces. During 2015, the Bank refined and enhanced its risk appetite statements under the RMF against each risk to provide further clarity.

3.i Credit risk

The current or prospective risk to earnings and/or capital arising from a borrower's failure to meet the terms of any contract with the Bank or the various subsidiaries of the Bank or such borrower's failure to perform as agreed.

Managing this risk is a fundamental part of what a bank does. The Bank's exposure to this risk is reducing as higher risk lending is deleveraged, however as with all other banks, the Bank remains exposed to macroeconomic and market-wide risks such as issues with the housing market and interest rate changes.

3.ii Liquidity and funding risk

The risk that the Bank's resources will prove inadequate to meet its liabilities as they contractually fall due or as a result of any contingent or discretionary cash outflows that may occur in a stress. It arises from the mismatch of timings of cash flows generated from the Bank's assets and liabilities (including derivatives). Should additional liquidity be required during a time of idiosyncratic or market wide stress or at a time of heightened macroeconomic uncertainty, this is likely to result in higher than anticipated funding costs which will negatively impact on retained earnings and therefore capital resources.

The Bank is reliant on its Retail deposit base as a major source of funding and given the relative size of the Bank's Retail deposit base as compared with other sources of funding the Bank is particularly exposed to liquidity risks, as a loss of confidence in the Bank by its customers may result in the loss of a high proportion of the Bank's funding.

3.iii Market risk

The risk that the value of assets and liabilities, earnings and/or capital may change as a result of changes in market prices of financial instruments. The majority of the Bank's market risk arises from changes in interest rates which is managed and hedged in line with the market risk policy to minimise earnings volatility.

Although the eventual impact of the EU referendum vote on market risk is dependent on economic and political outcomes which remain uncertain, the macroeconomic uncertainty created as a result of the EU referendum vote has introduced increased market risk volatility to which the Bank is exposed. This places further downward pressures on the Bank's forecast income and ability to generate sustainable capital strength.

The Bank's Treasury team manages interest rate risk. More information can be found in the risk management disclosures of the Bank's 2015 Annual Report and Accounts. The Bank's deleverage strategy is particularly susceptible to market risk and impacts the Bank's ability to continue to deleverage the entire Optimum portfolio.

3.iv Operational risk

The risk of loss resulting from inadequate or failed internal processes, people and systems, or external events. This encompasses the effectiveness of risk management techniques and controls to minimise these losses. Legal risk including litigation is also managed within the framework of operational risk.

The Bank is subject to a number of specific issues due to a lack of investment in systems and processes which has led to increased operational risk. In particular:

3.iv.i The Bank's IT system has been underinvested in for a considerable period of time.

The Bank has continued to improve its IT platforms during 2016 to address historic infrastructure and disaster recovery related issues, these improvements have resulted in a reduction in the Bank's level of technology related operational risk.

Since early 2014 the Bank has made material improvements in its ability to recover critical services in the event of failure of individual components of its IT infrastructure and all relevant components have now been addressed. The Bank is awaiting the outcome of a review by the FCA of the Bank's compliance with respect to IT related Threshold Conditions.

3.iv.ii Many of the Bank's business, operational, reporting and financial processes rely on significant manual processes and intervention which is inefficient and increases the risk of errors in the Bank's data and financial reporting. The Bank is subject to high levels of model risk which occurs as a direct result of weaknesses in the design, governance or use of a model.

The Bank's systems of control have been weak and although the foundations of more robust controls, including enhancements to the RMF in 2015 have been laid, this is taking more time than anticipated and significant work is still required to embed these across the organisation. These include the need to enhance general IT controls, including logical access and controls over the management of financial and customer data. The Bank has poor systems and manual processes, many of which have not been integrated following the Bank's merger with the Britannia in 2009, which exacerbates this risk. Until the RMF is fully embedded there is increased risk that inadequate risk management could lead to exposures outside the Bank's risk appetite, unanticipated losses and regulatory censure.

3.iv.iii Large scale outsourcings and transformation projects may be subject to significant risk of delay to completion, increased costs and operational disruption in the short term. Moreover, the Bank must ensure it has appropriate governance and processes to manage the relationship with outsourcing partners.

The Bank has entered into an outsourcing contract with Capita for the provision of mortgage origination and servicing processing. Capita has taken over and is currently operating the Bank's existing mortgage processing and this is operating satisfactorily using the Bank's existing infrastructure. Work is underway on the design and build of new Capita systems to deliver enhancements in mortgage origination and processing. New lending processing is intended, in time, to be undertaken on the new Capita systems to be followed by a phased migration of existing business. The intention is to deliver long term cost efficiencies and improved customer experience. This is now likely to be significantly delayed. Notwithstanding potential mitigation, there remains material uncertainty over the extent and implications of the delay in the transformation elements of the outsourcing contract with Capita. This could result in any of the following: increased costs; reduction in the transformation scope; and increased legal risk for the Bank. Consequently there is a risk of an adverse effect on the Bank's mortgage business and its Updated Plan.

3.iv.iv The Bank is in the process of separating from The Co-operative Group. Currently, and into the medium term, the Bank depends on The Co-operative Group to provide a number of services including critical functions such as IT (until various technology refresh programmes, notably the Enterprise Services arrangement with IBM described above becomes fully operational), personnel, assets and to on-supply certain services, data and assets by third party suppliers. The Bank also has significant counterparty exposure to The Co-operative Group. The ongoing separation project is complex and may be more costly than currently contemplated.

3.iv.v The Bank faces legal, financial and reputational risk where legal proceedings are brought against it, including as a result of the Bank's day-to-day business activity or encouraged by adverse findings of various investigations into events and activities at the Bank. Liability for damages may be incurred by the Bank where third parties are harmed by the conduct of the Bank's business.

3.iv.vi Fraud risk.
As with other banks, reflecting the increased use of technology in financial services, the Bank and its customers are at a risk of cyber-attacks including attacks designed to overload the Bank's systems. The Bank remains at risk that any cyber-attack may result in temporary lack of operational availability of the Bank's systems to its employees and/or customers. The Bank continues to manage fraud risk including cybercrime within risk tolerances to manage any resultant losses and to comply with all relevant legal and regulatory requirements.

3.v Reputational risk
The risk associated with an issue which could in some way be damaging to the reputation of the Bank. Underlying issues arising as a result of: (i) the Bank's strategic decisions or business performance; (ii) an operational failure; or (iii) external perception. This may result in a requirement to hold additional liquidity in anticipation of a stress scenario, which is likely to negatively impact retained earnings over time and therefore capital resources.

The Bank considers that its reputation as an ethically led organisation is critical to the success of the Updated Plan and actively seeks to manage and mitigate the risks that may impact its reputation. The Bank continues to rely on the Co-operative brand and therefore carries the risk that its brand may be damaged as a result of matters affecting The Co-operative Group or other co-operatives.

The Co-operative Bank trade mark belongs to the Bank. In certain circumstances the Bank's right to use the term 'co-operative' could be challenged or removed. The Secretary of State for Business, Energy and Industrial Strategy may direct the Bank to change its registered name if, in their opinion, it gives so misleading an indication of the nature of its activities as to be likely to cause harm to the public. Further, the FCA has the power to prevent the use of the term 'co-operative', or to take other action regarding the Bank's branding, if the FCA considers this desirable to protect consumers, to promote competition in the interests of consumers or to protect the integrity of the UK financial system. A loss of support from key stakeholders for the Bank's continued use of the term 'co-operative' may result in a risk these authorities could look to exercise their powers leading to legal, financial and reputational risk. The Bank manages this risk through its actions and commitment to the established values of the co-operative movement, as demonstrated by the embedding of co-operative values and ethics in its articles of association and its ethical policy.

The Bank and The Co-operative Group entered into branding co-existence principles in 2013 and had been negotiating a more detailed agreement which has not been finalised. The Bank continues to liaise with The Co-operative Group regarding use of trademarks and intellectual property relating to brand. If consensual outcomes are not agreed this could lead to potential legal, financial or reputational risk for the Bank.

3.vi Strategic and business risk
The risk arising from changes to the Bank's businesses and the environment in which it operates, specifically the risk of not being able to carry out the Bank's Updated Plan and desired strategy. This may result in the Bank having to hold additional capital and/or liquidity. This risk is covered by many areas of capital in Pillar 2, specifically execution, concentration and liquidity risk.

The Bank's Updated Plan to focus on becoming a smaller Core Bank is challenging, unproven and remains in the midst of implementation. The Bank does not have a track record in successful execution of the simultaneous large scale change necessary. Accordingly, there is an ongoing risk that the Bank is unable to implement the Updated Plan.

The Updated Plan involves concurrent transformational change, with a large component relating to IT, which may result in additional investment cost and delays to the Updated Plan. Any delay would require ongoing regulatory acceptance of these issues for a longer period of time which might not be forthcoming and could be withdrawn if the Updated Plan is not executed in line with regulatory expectations.

The Bank's Updated Plan requires the Bank to continue to deleverage Non-core assets and reduce execution risk across key transformation projects, which it may not be able to achieve.

If in due course the Bank becomes subject to a binding requirement to issue MREL and it is unable to do so when required, the Bank's Regulators can agree to accept the Bank's original issuance plan, a revised issuance plan, use their respective powers to require some other remediating action on the part of the Bank or in the absence of any of these the Bank of England may exercise its powers under the Banking Act 2009. In considering viability the Board has taken note of the contents of PRA consultation paper (CP 44/15) and the Board continues to believe that resolution is less likely than the other outcomes while the Bank is executing its plan as accepted by the PRA and continuing to de-risk the Bank.

Despite ongoing evidence of stability in the Core Bank franchise there is a risk that this position weakens due to currently unforeseen events. Furthermore, there is a risk that the Bank's strategy to deliver the Updated Plan may be insufficient to address all of the Bank's problems or deliver the projected benefits, particularly in light of increased uncertainty resulting from the UK EU referendum vote to leave the EU which may adversely affect the Bank's performance.

The macroeconomic uncertainty created as a result of the EU referendum vote places pressure on the Bank's ability to generate organic capital. As with all UK retail focused banks, the ability to improve net interest margin is significantly reduced in a lower for longer or reducing base rate environment, the likelihood of which is greatly increased following the EU referendum. This directly impacts the Bank's ability to generate sustainable profits in the quantum previously anticipated. Similarly, weaker outlooks for a number of other macroeconomic variables including unemployment, house prices and commercial real estate prices, are likely to adversely impact the Bank's capital requirements compared to those expected within the Updated Plan.

3.vii People risk
People risk is the risk associated with the recruitment, employment and management of individuals within the Bank. A significant portion of the Bank's cost base is staff costs and so managing this resource within budget is key to cost reduction and therefore to retained earnings. This risk is captured within the operational risk framework.

The Bank continues to be subject to heightened people risk. The ability to attract and retain staff remains an issue in the Bank's control functions. Despite improvement, employee turnover levels still remain high, reflecting the buoyancy of the external market. This increases execution risk in the Updated Plan and reduces historical corporate knowledge.

A number of key initiatives began during 2015 to tackle people risk issues. The Bank's Culture Programme sought to improve colleague engagement, reinforcing the Co-operative Bank Values and Culture, and embedding these into people policies and processes. Phase two of this programme was rolled out in the first half of 2016.

Employee engagement levels improved significantly throughout 2015 but have reduced in the first half of 2016, primarily due to reduced employee confidence in the business although the substantial gains made in 2015 in employee understanding of strategy, satisfaction with communications and trust in the senior leadership have been maintained.

The Bank remains exposed to the risk that its Executive and Board level succession plans are dependent on external recruitment. While this risk is reducing, the risk remains that the Bank may not be able to back-fill roles in a timely fashion with appropriate and sufficiently skilled replacements, exposing the Bank to operational disruption and potential delay in essential activities necessary for the Updated Plan to be successfully delivered. The Bank is similarly exposed to the on-going risk that Non-Executive Directors may not be able to be hired as current Non-Executive Directors serve their expected terms and stand down, particularly in the wake of increasing regulatory expectations of the Senior Manager Regime.

There is an increased risk to the retention and attraction of key skilled personnel resources associated with CRD IV not permitting variable pay whilst the Bank is incurring losses and receiving capital forbearance. The Bank announced a revised pay structure for staff, other than senior members of staff, in July 2016. The revised pay structure for senior members of staff is currently under review and has not yet been announced. There is a risk that any amended compensation approach could impact the attraction and retention of staff.

3.viii Regulatory risk

The risk of fines, public censure, limitation on business, requirements for legal or operational restructuring, or restitution costs arising from the failure to understand, interpret, implement and comply with UK and EU regulatory requirements.

Along with the wider banking industry, the Bank must comply with multiple regulatory changes which may add complexity to an already difficult technology, operational and prudential change programme.

There is also a risk that, both foreseen and unforeseen, changes to regulatory requirements affect the Bank's ability to successfully implement its Updated Plan or that the acceptance by regulatory authorities of the Bank's plan to address the various ways in which the Bank is currently non-compliant and which is essential for the Bank to continue to operate, is withdrawn.

The regulatory position of the Bank, including the Bank's compliance with ICG and CRR regulatory requirements, is described in section 2 at the start of the Principal Risks and Uncertainties above.

3.viii.i Competition

The personal financial services industry is mature, so growth often requires taking market share from competitors. The Bank faces risk of losing market share to other banks, building societies and insurance company competitors.

In addition, the Competition and Markets Authority (the CMA) published its final report on its market investigation into retail banking on 9 August 2016. The financial and other impact of the remedy package on the Bank is still under review and the impact on the wider industry as a whole is still uncertain. However, the remedies announced will require some change, cost and complexity to be managed in a relatively short timeframe, particularly in the development and implementation of an open Application Programming Interface (API) standard for banking, which could adversely affect the Bank's business, operating results and financial condition.

3.ix Conduct risk

This is the risk that the Bank's behaviour, offerings or interactions will result in unfair outcomes for customers.

The Bank is exposed to the inherent risks relating to the mis-selling of financial products, acting in breach of regulatory principles or requirements and giving negligent advice or other conduct determined by the Bank or the Regulators to be inappropriate, unfair or non-compliant with applicable law or regulations. Any failure to manage these risks adequately could lead to further significant provisions, costs and liabilities and/or reputational damage. The Bank's approach to provisions for historic mis-selling issues such as PPI, interest rate swaps and packaged accounts is based on the views and requirements of the Regulators. Any change in the Regulator's current approach could have a material impact.

During 2015, the FCA proposed a time bar on PPI claims (which of itself could be subject to judicial challenge) and a dedicated marketing campaign to consumers as to their right to reclaim PPI. The FCA's proposals have been revised into their latest consultation paper CP16/20 which contemplates a time bar to June 2019 for new PPI complaints and reconsiders the approach to redress calculations in relation to profit share. These new variables create challenges to accurately model future redress with certainty. As at June 2016, a provision of £101.9m (2015: £87.0m) had been recorded in respect of potential customer redress and costs relating to past sales of PPI. This includes a £33.5m charge in 2016 following an initial assessment of the impact of the FCA's latest proposals and minor policy revisions. Forecast future complaint volumes are difficult to predict and may increase, remain constant or decline more steadily due to the proposed time bar and FCA communications campaign. Accordingly, the time bar and advertising campaign may increase the overall level of claims that may be experienced by the Bank in H2 2016 and beyond.

The Bank has substantially completed its programme of a structured risk based assessment of products and provisions, of which the primary focus was the discovery and remediation of existing and new conduct and legal issues. The Bank is currently investigating a number of potential conduct issues arising out of historical mortgage systems configuration. While progress has been made in resolving conduct issues, no assurance can be given that further issues will not be identified, or that any such further or already identified issues may not require new or further provision, or that changes in regulation may not give rise to further conduct risks emerging.

As well as PPI, the Bank continues to monitor developments in certain product related areas, which are attracting increased focus, in some cases from both the courts and the FOS, including loan early repayment charges, variation of certain product terms and conditions and the

outcome of the judicial review of an IRHP (Interest Rate Hedging Product) loan granted by another lender and the related FCA remediation rules. Changes in the approach to any of these issues in the market could adversely affect the Bank.
The Bank has set up projects to remediate existing conduct issues. However, these are costly, complicated and require significant data extracts and IT support to implement. Delays or failure to successfully implement redress to customers increases the costs to the Bank and may lead to regulatory sanction.

The Bank initiated a redress programme in respect of various breaches of mortgage conduct of business rules and was the subject of a skilled persons review into potential detriment to its mortgage customers arising from poor arrears handling. The Bank has substantially completed the recommendations from this review and has implemented enhanced policies and processes which are designed to deliver improved customer outcomes. The outcome of the final review is not yet finalised but the risk of further enforcement action by the FCA is considered to be largely mitigated.

The Bank continues to be exposed to the risks of non-compliance with the Consumer Credit Act (CCA).The Bank has identified certain instances where its documentation or processes have not been fully compliant with the technical requirements of the CCA. Until remediation of the issues identified is complete, the Bank remains in breach of the technical requirements of the CCA and will be unable to apply interest charges or take enforcement action on the affected accounts. The consequences of non-compliance with the technical requirements of the CCA can include interest and default charges paid by a customer in prior periods being required to be refunded and the customer agreement not being enforceable by the Bank without a court order until the breach is remedied. In very limited circumstances, the Bank may be unable to rectify the historic issues accurately or at all, which may lead to continuing non-compliance with the CCA.

3.x Pension risk

The risk to the Bank's capital, funds and unencumbered assets from the Bank's exposure to scheme liabilities (to the extent liabilities are not met by scheme assets) and risks inherent in the valuation of scheme liabilities and assets, including that the Bank is required as a result of agreements reached with pension scheme trustees to make ongoing contributions to fund such scheme deficits.

3.x.i Pace

The Bank is a participating employer in Pace, which has both an active defined contribution section and a closed defined benefit section. The Pace Scheme is not currently sectionalised and operates on a 'last man standing' basis, with a risk that the Bank's obligation to Pace would therefore increase significantly if another large employer in the scheme (the largest of which is The Co-operative Group) were to become insolvent. To mitigate this risk, the Bank is now in consultation with The Co-operative Group and the Pace Scheme Trustee with the aim of separating its liabilities in the scheme from those of other participating employers. At present, there is uncertainty over the Bank's share of Pace liabilities, which the Bank is expecting to resolve as a part of the separation discussion.

Once the Bank's share of Pace is sufficiently known, the Bank will be required to begin defined benefit accounting for Pace which, though the scheme is currently in accounting surplus, would require the recognition of any future accounting deficit on the Bank balance sheet, and recognise in full any future schedule of deficit contributions at the point they are committed to. Further, until separation is agreed there is uncertainty as to the quantum of liabilities for which the Bank will take responsibility and the funding contributions required in a separated scheme.

The next triennial valuation of the defined benefit section of Pace will be determined as of 5 April 2016, with the statutory deadline for completion being 5 July 2017. Until this is completed, there is uncertainty as to the funding deficit in the scheme at the valuation date and the consequent deficit that the Bank will contribute towards, over which uncertainty exists irrespective of whether separation is completed.

3.x.ii Britannia

The Bank is the sponsor of the Britannia Pension Scheme, which is a closed defined benefit scheme. The scheme's triennial actuarial valuation, as at 5 April 2014 is in the process of finalisation. Until finalised, there remains uncertainty over the quantum and profile of cash contributions the Bank will be required to make to make good the deficit in the scheme at the valuation date. The next triennial valuation will be undertaken as of 5 April 2017 and with the current macroeconomic outlook, there may be heightened risk that the scheme's funding position may have worsened by such time and the subsequent risk that the Bank may be required to fund an increased level of deficit.

Some of the risk posed to the Bank's capital resiliency has however been mitigated in H1 2016 as, in consultation with the Trustee, a number of changes were made to the scheme rules whereby the Bank is now deemed to have a right to a refund over any surplus that might arise at the end of the scheme's natural life, or in a wind-up scenario. This has the effect that the Bank is not required to recognise a liability for any deficit contributions it has committed to.

Footnotes to Principal Risks and Uncertainties

1. Details how the Bank of England's resolution powers under the Banking Act 2009 generally operate can be found in the document 'The Bank of England's approach to resolution, October 2014' which can be found on its website at:
http://www.bankofengland.co.uk/financialstability/Documents/resolution/apr231014.pdf

2. PRA CP 44/15 'The minimum requirements for own funds and eligible liabilities (MREL) Buffer and Threshold Conditions' was published on 11 December 2015 and sets out that PRA processes to adopt a policy that if a firm is in breach of its MREL requirement, it would not automatically mean that the PRA will consider the firm is failing, or likely to fail, to satisfy Threshold Conditions.

3. These Threshold Conditions are set out in Schedule 6 of the Financial Services and Markets Act 2000 as amended by the Financial Services and Markets Act 2000 (Threshold Conditions) Order 2013. Threshold Conditions set out the minimum standards to be met relating to financial and non-financial resources, including capital, risk management, liquidity, and technology. The Threshold Conditions differ depending on whether a firm is PRA-regulated or not.

RESPONSIBILITY STATEMENT

We confirm that to the best of our knowledge:

- The condensed set of financial statements has been prepared in accordance with IAS 34 Interim Financial Reporting as adopted by the EU; and

- The interim management report includes a fair review of the information required by:

  - DTR 4.2.7R of the Disclosure and Transparency Rules, being an indication of important events that have occurred during the first half of the financial year and their impact on the condensed set of financial statements; and a description of the principal risks and uncertainties for the remaining half of the year; and
  - DTR 4.2.8R of the Disclosure and Transparency Rules, being related party transactions that have taken place in the first half of the current financial year and that have materially affected the financial position or performance of the entity during that period; and any changes in the related party transactions described in the last annual report that could do so.

By Order of the Board

Niall Booker
Chief Executive
17 August 2016

The Co-operative Bank plc Board of Directors:

Dennis Holt	Chairman
Niall Scott Kilgour Booker	Chief Executive Officer
Liam John Coleman	Deputy Chief Executive Officer
John Baines	Chief Financial Officer
Aidan Birkett	Senior Independent Director
Laura Martine Carstensen	Non-Executive Director
John Richard Coates	Non-Executive Director
Maureen Laurie	Non-Executive Director
William Gennydd Thomas	Non-Executive Director
Derek James Weir	Non-Executive Director
Charles Bralver	Non-Executive Director

RISK MANAGEMENT

1. Changes to the risk management objectives and policies

1.1 Overview

The Bank has a formal structure for reporting, monitoring and managing risks across the Bank. This comprises, at its highest level, Risk Appetite Statements which are set and approved by the Board and are supported by granular risk appetite measures across the Bank's principal risk categories. This is underpinned by a RMF which sets out the high level policy, standards, roles, responsibilities, governance and oversight for the management of all risks across the Bank.

During the first half of the year the Bank continued to review its RMF which focused on aligning roles and responsibilities between first and second lines of defence, updating the Bank's policy framework and the Bank's committee structure. The Bank will continue to review and enhance its RMF throughout 2016.

Risks and issues, whether crystallised or emerging inclusive of those observed in relation to the RMF are detailed within the Principal Risks and Uncertainties.

1.2 Approach to risk management

Responsibility for risk management resides at all levels of the Bank from the Board and the Executive Committee supported by Senior Management Committees through the organisation to each business area subject to appropriate oversight. In line with this approach the Bank adopts the three lines of defence governance model which is outlined below:

- the Bank's business teams act as first line of defence and are responsible for identifying where a business area is exposed to risks, including from the development of new products, processes or other business change. They also manage the risks that reside within their business area on a day-to-day basis, implementing monitoring and control processes to ensure that the Bank's business profile is understood and maintained within Board defined risk appetite;

- the Bank's Risk Framework Owners act as the second line of defence. They draft the relevant policies, oversee and challenge the implementation and monitoring of the RMF and consider current and emerging risks across the Bank. They also oversee the appropriate escalation of breaches of appetite, mitigating actions and report these to the mandated Senior Management Committee; and

- the Bank's Internal Audit function acts as the third line of defence. They are responsible for independently verifying that the RMF has been implemented as intended across the Bank, and independently challenge the overall management of the framework to provide assurance to the Audit Committee and senior management on the adequacy of both first and second lines.

1.3 Risk management strategy and appetite

The Board has primary responsibility for identifying the key business risks facing the Bank, approving the Bank's Risk Management Strategy which includes setting the risk appetite which defines the type and amount of risk that the Bank is prepared to accept both qualitatively and quantitatively in pursuit of its strategic objectives. In addition the Board approves key regulatory documents including the Internal Liquidity Adequacy Assessment Process (ILAAP) and the Internal Capital Adequacy Assessment Process (ICAAP) which also includes appropriate stress testing, scenario analysis and contingency planning allowing it to understand the impact of potentially severe risks to ensure that it remains resilient to them.

The Bank's risk appetite is translated into specific risk measures that are tracked and monitored and reported to the appropriate Risk Committees of the Bank and the Board. The Bank's Risk Appetite Framework has been designed to create clear links to the Bank's planning process whereby appropriate metrics and limits for each risk category are clearly established, calibrated and reported.

2. Credit risk

2.1 Overview and credit exposure

Credit risk is part of the principal risks set out in the RMF is an integral part of the business activities. Credit risk is managed through a framework that sets out policies and procedures covering both its measurement and management. There is a clear segregation of duties between transaction originators in the businesses and approvers in the Risk function. All credit exposure limits are approved within a defined credit approval authority framework. The Bank manages its credit exposures through diversification across products, geographies, client and customer segments.

The following analysis of credit exposure shows:

- carrying amounts by class of asset in the balance sheet;
- the gross credit exposure by class of asset (excluding allowance for losses but including credit commitments); and
- the net credit exposure by class of asset (including allowance for losses and credit commitments).

Cash and balances at central banks are credit exposures with the Bank of England and have been excluded from the analysis. Impaired and not impaired balances in the tables below are defined in the following sections on Retail credit risk, Corporate credit risk and investment securities credit risk.

All amounts are stated in £m unless otherwise indicated.

As at 30 June 2016	**Loans and advances to banks**	**Loans and advances to customers**	**Investment securities**	**Derivative financial instruments**	**Total**
Analysis of balance in notes[1]		9	10		
Gross balance	**1,138.8**	**19,815.0**	**3,742.2**	**625.4**	**25,321.4**
Less: allowance for losses	**-**	**(199.6)**	**-**	**-**	**(199.6)**
	1,138.8	**19,615.4**	**3,742.2**	**625.4**	**25,121.8**
Analysis of credit risk exposure					
Not impaired	**1,138.8**	**18,950.2**	**3,742.2**	**625.4**	**24,456.6**
Impaired	**-**	**864.8**	**-**	**-**	**864.8**
	1,138.8	**19,815.0**	**3,742.2**	**625.4**	**25,321.4**
Credit commitments	**-**	**2,611.5**			**2,611.5**
Gross credit risk exposure	**1,138.8**	**22,426.5**	**3,742.2**	**625.4**	**27,932.9**
Less: Allowance for losses	**-**	**(199.6)**	**-**	**-**	**(199.6)**
Net credit risk exposure	**1,138.8**	**22,226.9**	**3,742.2**	**625.4**	**27,733.3**

As at 31 December 2015	Loans and advances to banks	Loans and advances to customers	Investment securities	Derivative financial instruments	Total
Analysis of balance in notes		9	10		
Gross balance	871.0	19,935.6	4,894.2	370.1	26,070.9
Less: allowance for losses	-	(245.2)	-	-	(245.2)

	871.0	19,690.4	4,894.2	370.1	25,825.7
Analysis of credit risk exposure					
Not impaired	871.0	18,908.8	4,894.2	370.1	25,044.1
Impaired	-	1,026.8	-	-	1,026.8
	871.0	19,935.6	4,894.2	370.1	26,070.9
Credit commitments	-	2,710.2	-	-	2,710.2
Gross credit risk exposure	871.0	22,645.8	4,894.2	370.1	28,781.1
Less: Allowance for losses	-	(245.2)	-	-	(245.2)
Net credit risk exposure	871.0	22,400.6	4,894.2	370.1	28,535.9

1. Includes £20.0m of Corporate loans and advances in non-current assets classified as held for sale.

2.2 Credit risk management
The following sections provide further analysis and disclosure of the Bank's credit risk associated with:

2.2.1 Loans and advances to customers;
2.2.2 Investment securities;
2.2.3 Loans and advances to banks;
2.2.4 Derivative financial instruments; and
2.2.5 Wholesale credit risk.

2.2.1 Loans and advances to customers
The tables below analyse gross balances by impairment classification. They include credit commitments, impairment provisions, fair value adjustments and reconciliation to gross customer balances. This is the basis on which the business manages risk. The disclosures in sections secured residential credit risk, Retail unsecured credit risk and Corporate credit risk are all based on the gross customer balances in the below tables (unless otherwise noted).

The Non-core business continues to carry additional impairment risk. This includes Optimum, a closed book of predominantly interest-only intermediary and acquired mortgage book assets. Worsening economic and market conditions and/or increasing interest rates and/or a fall in house prices could result in the Optimum assets suffering from more than expected impairments. The Non-core business' Corporate CoAM asset book is also relatively concentrated, with the result that a small number of borrowers account for a large proportion of the total balance outstanding. Any significant future impairment of these borrowers would result in a disproportionate impact on the level of impairment. During 2016, the risk of this occurring reduced due to the deleverage of the Corporate CoAM book. This has reduced the overall Non-core balance to £4.1bn as at 30 June 2016.

The Bank's exposures are predominantly within the UK and so any geographic analysis is only UK based. At 30 June 2016 the amount of overseas exposure is £100.3m (split across Corporate and Unsecured). This represents 0.4% of the total credit risk exposure.

Other accounting adjustments include accrued interest, interest fair value adjustments, effective interest rate adjustments and Britannia merger fair valued Lifetime Expected Losses (LEL). The value of the LEL represents a difference in the externally reported level of impairment against the gross impairment calculated by Credit Risk.as the LEL is an accounting adjustment and Credit Risk manage these assets on a gross customer balance basis. The value of the LEL fair value adjustments significantly reduced in 2015 due to the deleverage of the Corporate CoAM book and Warwick Finance One and Warwick Finance Two securitisations of the Optimum book, so that they have now largely aligned the level of gross and net fair value impairment.

	Core			Non-core		
	Retail banking					
As at 30 June 2016	**Secured**	**Unsecured**	**BaCB**	**Corporate CoAM**	**Optimum**	**Total**
Analysis of balance in note 9[1]						
Gross loans and advances	**13,896.5**	**779.0**	**893.9**	**1,503.7**	**2,741.9**	**19,815.0**
Less: allowance for losses	**(3.7)**	**(95.8)**	**(1.9)**	**(84.0)**	**(14.2)**	**(199.6)**
	13,892.8	**683.2**	**892.0**	**1,419.7**	**2,727.7**	**19,615.4**
Analysis of credit risk exposure						
Not impaired	**13,715.3**	**660.4**	**869.8**	**1,269.1**	**2,435.6**	**18,950.2**
Impaired	**181.2**	**118.6**	**24.1**	**234.6**	**306.3**	**864.8**
	13,896.5	**779.0**	**893.9**	**1,503.7**	**2,741.9**	**19,815.0**
Credit commitments	**448.6**	**1,753.1**	**275.5**	**134.3**	**-**	**2,611.5**
Gross credit risk exposure	**14,345.1**	**2,532.1**	**1,169.4**	**1,638.0**	**2,741.9**	**22,426.5**
Less: Allowance for losses	**(3.7)**	**(95.8)**	**(1.9)**	**(84.0)**	**(14.2)**	**(199.6)**
Net credit risk exposure	**14,341.4**	**2,436.3**	**1,167.5**	**1,554.0**	**2,727.7**	**22,226.9**
Reconciliation of accounting to customer balances						

Gross loans and advances	**13,896.5**	**779.0**	**893.9**	**1,503.7**	**2,741.9**	**19,815.0**
Other accounting adjustments	**(45.4)**	**(13.6)**	**1.7**	**(46.5)**	**14.9**	**(88.9)**
Gross customer balances	**13,851.1**	**765.4**	**895.6**	**1,457.2**	**2,756.8**	**19,726.1**

	Core			Non-core		
	Retail banking					
As at 31 December 2015 (Restated)	Secured	Unsecured	BaCB	Corporate CoAM	Optimum	Total
Analysis of balance in note 9						
Gross loans and advances	13,456.5	878.3	549.4	2,176.9	2,874.5	19,935.6
Less: allowance for losses	(3.8)	(100.5)	(1.8)	(125.9)	(13.2)	(245.2)
	13,452.7	777.8	547.6	2,051.0	2,861.3	19,690.4
Analysis of credit risk exposure						
Not impaired	13,261.8	751.5	516.6	1,822.8	2,556.1	18,908.8
Impaired	194.7	126.8	32.8	354.1	318.4	1,026.8
	13,456.5	878.3	549.4	2,176.9	2,874.5	19,935.6
Credit commitments	514.1	1,810.1	180.2	205.8	-	2,710.2
Gross credit risk exposure	13,970.6	2,688.4	729.6	2,382.7	2,874.5	22,645.8
Less: Allowance for losses	(3.8)	(100.5)	(1.8)	(125.9)	(13.2)	(245.2)
Net credit risk exposure	13,966.8	2,587.9	727.8	2,256.8	2,861.3	22,400.6
Reconciliation of accounting to customer balances						
Gross loans and advances	13,456.5	878.3	549.4	2,176.9	2,874.5	19,935.6
Other accounting adjustments	(85.5)	(41.4)	3.1	(24.7)	12.2	(136.3)
Gross customer balances	13,371.0	836.9	552.5	2,152.2	2,886.7	19,799.3

1. Includes £20.0m of Corporate loans and advances in Non-current assets classified as held for sale.

Secured residential credit risk

Acquisition and account management

Mortgages are loans to customers secured by a first charge over a residential property. Mortgages are originated directly to customers via branches, telephone and the internet under the Britannia and The Co-operative Bank brands, and via intermediaries under the Platform brand. In the first half of 2016, 13.6% (31 December 2015: 12.8%) of mortgages were originated directly and 86.4% (31 December 2015: 87.2%) through intermediaries.

The Britannia and The Co-operative Bank brands only originate prime residential mortgages, while Platform currently originates a combination of prime residential and buy-to-let loans. Historically, these loans have been advanced on a capital and interest payment basis, where the loan is repaid over the term of the loan, or interest only, where the capital element of the loan is repayable at the end of the term. All new advances are on a capital repayment basis, with the exception of buy-to-let lending and existing interest only loans for customers moving home.

During the term of the mortgage, interest only mortgages are managed consistently with capital and repayment mortgages. In addition, the Bank determines if the customer has a satisfactory repayment strategy in place on loan maturity, in line with our customer contact strategy.

The table below shows residential mortgage completions in the period, analysed by loan-to-value (LTV) and repayment method.

	Period to 30 June 2016			Year to 31 December 2015		
	Amount advanced	**Average LTV %**	**Interest only %**	Amount advanced	Average LTV %	Interest only %
Retail prime	**209.8**	**60.8**	**0.5**	357.1	60.8	0.9
Platform prime	**1,095.5**	**70.1**	**-**	1,962.8	73.9	-
Total prime	**1,305.3**	**68.6**	**0.1**	2,319.9	71.5	0.1
Buy-to-let	**237.4**	**65.4**	**90.3**	475.2	67.0	89.6
Almost prime	**-**	**-**	**-**	-	-	-
Total completions	**1,542.7**	**68.1**	**14.0**	2,795.1	70.7	15.4

The level of completions are managed via pricing strategy changes and have continued at the level from H2 2015. These levels combined with a low level of redemptions have resulted in the growth of the Retail Secured book.

Risk in the portfolio is recalculated monthly, using internally developed behavioural models. A regional house price index is used to reflect any changes in the value of collateral updated on a quarterly basis. This process is also used to determine the amount of capital which is required to be held for individual loans.

Mortgages originated prior to 2009, by Platform, or acquired by Britannia, are managed as part of a closed portfolio, Optimum. These loans include a range of asset types, including prime residential (both income verified and self-certified), buy-to-let and non-conforming mortgages.

	Gross customer balance as at 30 June 2016				
	Retail secured		**Optimum**		
LTV %	**Capital Repayment**	**Interest Only**	**Capital Repayment**	**Interest Only**	**Total**
Less than 50%	**4,825.2**	**1,795.5**	**170.7**	**422.3**	**7,213.7**
50% to 60%	**1,715.3**	**644.2**	**74.9**	**427.1**	**2,861.5**
60% to 70%	**1,818.8**	**554.9**	**83.5**	**446.5**	**2,903.7**
70% to 80%	**1,364.2**	**214.4**	**50.2**	**460.9**	**2,089.7**
80% to 90%	**732.2**	**59.7**	**17.8**	**343.8**	**1,153.5**
90% to 100%	**77.6**	**33.8**	**3.0**	**188.6**	**303.0**
Greater than 100%	**4.4**	**10.9**	**1.8**	**65.7**	**82.8**
	10,537.7	**3,313.4**	**401.9**	**2,354.9**	**16,607.9**

	Gross customer balance as at 31 December 2015 (Re-presented)				
	Retail secured		Optimum		
LTV %	Capital Repayment	Interest Only	Capital Repayment	Interest Only	Total
Less than 50%	4,605.2	1,792.1	162.8	291.7	6,851.8
50% to 60%	1,708.1	650.3	84.0	383.2	2,825.6
60% to 70%	1,722.0	565.2	86.9	518.1	2,892.2
70% to 80%	1,187.7	241.1	70.3	563.5	2,062.6
80% to 90%	679.7	75.9	22.0	419.4	1,197.0
90% to 100%	86.9	39.1	3.9	205.9	335.8
Greater than 100%	4.8	12.9	2.3	72.7	92.7
	9,994.4	3,376.6	432.2	2,454.5	16,257.7

Interest only includes mortgages on a part-repayment and part-interest only basis.

The table below shows gross customer balances for residential mortgages analysed by asset class, the LTV shown is the current average percentage:

	As at 30 June 2016					
	Retail secured			**Optimum**		
	Gross customer balance	**Average LTV %**	**Interest only %**	**Gross customer balance**	**Average LTV %**	**Interest only %**
Prime residential	**12,571.9**	**49.3**	**12.9**	**181.2**	**67.5**	**83.8**
Buy-to-let	**1,190.6**	**56.2**	**89.0**	**939.1**	**62.9**	**94.5**
Self-certified	**57.9**	**37.6**	**88.3**	**796.5**	**63.8**	**86.6**
Almost prime	**29.4**	**43.2**	**33.0**	**444.0**	**75.1**	**77.3**
Non-conforming	**1.3**	**55.0**	**47.8**	**396.0**	**61.8**	**70.1**
	13,851.1	**49.8**	**19.8**	**2,756.8**	**65.2**	**85.2**

	As at 31 December 2015					
	Retail secured			Optimum		
	Gross customer balance	Average LTV %	Interest only %	Gross customer balance	Average LTV %	Interest only %
Prime residential	12,241.4	49.1	14.3	190.8	70.5	83.4
Buy-to-let	1,034.7	56.9	88.5	984.2	65.1	94.3
Self-certified	61.2	39.9	87.2	830.6	66.3	86.1
Almost prime	32.4	44.4	33.1	464.1	77.8	76.8
Non-conforming	1.3	55.8	47.1	417.0	63.6	69.6
	13,371.0	49.7	20.4	2,886.7	67.6	84.8

The table below show gross customer balances analysed by geographical location:

	As at 30 June 2016		As at 31 December 2015	
	Retail secured	**Optimum**	Retail secured	Optimum
London & South East	**5,922.0**	**1,241.7**	5,514.3	1,311.7
Northern England	**2,757.4**	**612.2**	2,744.2	633.0

Midlands & East Anglia	**2,861.9**	**444.2**	2,842.1	465.2
Wales & South West	**1,634.8**	**274.4**	1,611.6	285.7
Other	**675.0**	**184.3**	658.8	191.1
Total	**13,851.1**	**2,756.8**	13,371.0	2,886.7

Impairment

The table shown below reports coverage ratios calculated using:

- carrying values in the accounts; and
- impaired balances defined as one or more payments past due, forborne or in default (6+ months past due, possession, litigation, bankruptcy or Law of Property Act (LPA) receiver appointed).

The split of the impaired and non-impaired balance shown over the next two tables has been restated for 2015 to reflect the inclusion of non-defaulted forborne customers to align to the 2016 reported position.

	As at 30 June 2016		As at 31 December 2015 (Restated)	
	Retail secured	**Optimum**	Retail secured	Optimum
Gross loans and advances	**13,896.5**	**2,741.9**	13,456.5	2,874.5
of which impaired	**181.2**	**306.3**	194.7	318.4
Impaired as a % of gross loans and advances	**1.3%**	**11.2%**	1.4%	11.1%
Allowance for losses	**3.7**	**14.2**	3.8	13.2
Coverage	**2.0%**	**4.6%**	2.0%	4.1%

The increase in Optimum impairment provisions in the period to 30 June 2016 was largely driven by a refresh of model parameters, most notably increasing provisions associated with interest only mortgages.

The Bank regularly reviews its portfolio which includes a calculation of coverage ratios by reference to 90+ days past due and default balances. On this basis:

- the Retail 90+ days past due and default balance is £51.3m (2015: £52.3m) 0.4% of total customer balances (2015: 0.4%) and the coverage ratio is 7.2% (2015: 7.3%); and

- the Optimum 90+ days past due and default balance is £144.7m (2015: £152.5m) 5.2% of total customer balances (2015: 5.3%) and the coverage ratio is 15.6% (2015: 19.2%).

The movements in impaired gross customer balances during the period are shown below:

	As at 30 June 2016		As at 31 December 2015 (Restated)	
	Retail secured	**Optimum**	Retail secured	Optimum
Balance at start of the period	**194.7**	**318.4**	178.3	957.6
Classified as impaired during the period	**59.7**	**73.4**	98.3	97.1
Transferred to unimpaired during the period	**(54.8)**	**(59.9)**	(53.0)	(99.6)
Net repayments and other	**(18.4)**	**(25.6)**	(28.9)	(636.7)
Balance at the end of the period	**181.2**	**306.3**	194.7	318.4

Forbearance

Forbearance occurs when, for reasons relating to actual or apparent financial difficulty of the borrower, a temporary or permanent concession is granted. A concession may involve short term restructuring of the payment terms of the loan or an extension of the maturity date. The primary aim of forbearance is to help the borrower through period of financial difficulty and return the account into a sustainable position where the facility can be serviced through to full repayment. Where the primary aim cannot be achieved, the secondary aim is to maximise recovery of debt.

A number of forbearance options, including concessionary arrangements, are available to borrowers in financial difficulty. These are handled either with customers directly or through a third party whom they have chosen to represent them. Accounts classified as forborne remain so until the period of financial difficulty has passed and the account has demonstrated it can operate under sustainable terms.

The table below analyses secured residential mortgage balances by type of forbearance and the associated gross impairment coverage (including credit fair value adjustments):

	As at 30 June 2016				As at 31 December 2015 (Restated)			
Retail secured	**Non arrears**	**In arrears or defaulted**	**Total**	**Impairment coverage**	Non arrears	In arrears or defaulted	Total	Impairment coverage

Concessions	**2.7**	**5.2**	**7.9**	**(0.1)**	3.0	4.8	7.8	-
Arrangements	**9.9**	**14.7**	**24.6**	**(0.2)**	7.5	13.8	21.3	(0.2)
Term extensions	**19.1**	**0.1**	**19.2**	**-**	32.3	-	32.3	-
Assisted Voluntary Sale	**-**	**0.1**	**0.1**	**-**	-	0.1	0.1	-
Interest only switches	**1.3**	**0.3**	**1.6**	**-**	0.6	-	0.6	-
Term expired	**50.9**	**4.4**	**55.3**	**(0.4)**	46.4	3.4	49.8	(0.2)
	83.9	**24.8**	**108.7**	**(0.7)**	89.8	22.1	111.9	(0.4)

	As at 30 June 2016				As at 31 December 2015 (Restated)			
Optimum	**Non arrears**	**In arrears or defaulted**	**Total**	**Impairment coverage**	Non defaulted	In arrears or defaulted	Total	Impairment coverage
Concessions	**2.9**	**8.8**	**11.7**	**(0.4)**	2.8	5.5	8.3	(0.2)
Arrangements	**21.7**	**72.4**	**94.1**	**(4.7)**	18.5	72.0	90.5	(4.4)
Term extensions	**0.4**	**0.1**	**0.5**	**-**	0.8	-	0.8	-
Assisted Voluntary Sale	**-**	**-**	**-**	**-**	-	-	-	-
Interest only switches	**0.1**	**-**	**0.1**	**-**	-	-	-	-
Term expired	**25.0**	**5.2**	**30.2**	**(1.4)**	18.9	2.7	21.6	(0.8)
	50.1	**86.5**	**136.6**	**(6.5)**	41.0	80.2	121.2	(5.4)

The categorisation of forbearance has been amended during the period to 30 June 2016 and therefore there has been a restatement of the position as at 31 December 2015 to allow direct comparison. The main differences are i) addition of interest only term expired accounts and court ordered arrangements in the categorisation of forbearance; ii) redefining term extensions to include all customers who have taken this option. Term expired customers are outside of the agreed terms and conditions of their mortgage even where they continue to make the previously agreed contractual monthly payment, as full repayment of the outstanding balance is past due. Therefore, they are deemed to have had a temporary concession granted and categorised as forborne. The Bank is actively working with this group of customers to determine appropriate solutions for repayment.

Retail forbearance balances have reduced by £3.2m (2.8%) since 31 December 2015 year end primarily due to lower volumes of term extensions being agreed in H1 2016 compared to H2 2015.

Optimum forbearance balances have increased by £15.4m (12.7%) since 31 December 2015 primarily due to the term expired balances being £8.6m higher.

Additionally, there are higher levels of arrangements and concessions, across both Retail and Optimum portfolios, which results from an increased focus on ensuring customers in financial difficulty are supported and placed on the most appropriate treatment option.

Retail IRB RWA by PD grade

The table below analyses each Retail (Secured and Optimum excluding Calico) IRB exposure by PD grade. Note that Exposure value pre-CCF comprises the gross customer balances and commitments.

Internal grades	**PD range %**	**Exposure value pre-CCF £m**	**Exposure at default £m**	**Average PD %**	**Average LGD %**	**RW %**	**RWA £m**
As at 30 June 2016							
Retail secured by immovable property							
1	**0.00 to 0.04**	**2,477.7**	**2,542.7**	**0.03%**	**6.6%**	**0.7%**	**18.9**
2	**0.04 to 0.07**	**3,296.5**	**3,376.0**	**0.06%**	**8.9%**	**1.7%**	**57.7**
3	**0.07 to 0.31**	**2,558.2**	**2,620.2**	**0.16%**	**10.2%**	**3.7%**	**97.5**
4	**0.31 to 1.00**	**4,260.3**	**4,357.2**	**0.54%**	**10.9%**	**10.0%**	**434.5**
5	**1.00 to 3.00**	**1,963.1**	**2,009.7**	**1.56%**	**13.3%**	**27.4%**	**549.7**
6	**3.00 to 15.32**	**279.1**	**286.1**	**7.27%**	**15.4%**	**75.1%**	**215.0**
7	**15.32 to 99.99**	**524.1**	**491.0**	**54.46%**	**7.8%**	**32.6%**	**160.0**
8	**100.00**	**224.0**	**224.0**	**100.00%**	**17.1%**	**236.5%**	**529.8**
Total Retail secured by immovable property		**15,583.0**	**15,906.9**	**3.61%**	**10.0%**	**13.0%**	**2,063.1**

Internal grades	PD range %	Exposure value pre-CCF £m	Exposure at default £m	Average PD %	Average LGD %	RW %	RWA £m
As at 31 December 2015							

Retail secured by immovable property							
1	0.00 to 0.04	2,668.4	2,739.4	0.04%	7.3%	0.8%	22.4
2	0.04 to 0.07	3,517.6	3,606.4	0.06%	9.8%	1.8%	65.7
3	0.07 to 0.31	2,567.2	2,630.8	0.16%	10.7%	3.9%	102.6
4	0.31 to 1.00	3,660.3	3,751.0	0.53%	11.3%	10.1%	380.1
5	1.00 to 3.00	1,664.6	1,705.6	1.57%	12.4%	25.8%	439.7
6	3.00 to 15.32	312.8	320.8	7.28%	15.5%	74.1%	237.7
7	15.32 to 99.99	619.3	578.6	57.72%	8.4%	31.1%	179.8
8	100.00	231.0	231.0	100.00%	17.9%	242.2%	559.4
Total Retail secured by immovable property		15,241.2	15,563.6	4.13%	10.3%	12.8%	1,987.4

EAD has increased by £343.3m in the period to 30 June 2016, driven by growth in the Platform portfolio. Increases in RWA reflect the increase in EAD with RW% remaining broadly stable. Overall RWA has increased by £75.6m (3.8%), from £1.987bn to £2.063bn, due to Platform growth (£185.0m), offset by reductions in the remaining Core mortgage portfolios (£46.0m) and Optimum (£64.0m).

Unsecured retail credit risk
An impairment provision is recognised for the following categories:

• identified impairment – at one penny, one day past due, forborne or in excess, based on the probability of default and the discounted cash flow of recoveries from default; and

• unidentified impairment – on the performing book, based on the probability of the emergence of delinquencies, the probability of default and the discounted cash flow of recoveries from default.

Coverage ratios calculated using carrying values in the accounts are shown in the table below:

	As at 30 June 2016	As at 31 December 2015
Gross loans and advances	**779.0**	878.3
of which impaired	**118.6**	126.8
Impaired as a % of gross loans and advances	**15.2%**	14.4%
Allowance for losses	**95.8**	100.5
Coverage	**80.8%**	79.3%

A reduction of £99.3m (11.3%) in gross loans and advances in the six months to 30 June 2016 is driven by asset amortisation and low volumes of new business across all portfolios, most notably a decline in loan balances. A reduction in unsecured balances results in a release in allowance for losses, however, both percentage of impaired loans and coverage marginally increases due to slight deterioration in asset quality.

Unsecured Retail IRB RWA by PD grade
The tables below analyse each retail unsecured IRB exposure class by PD grade. Note that Exposure value pre-CCF comprises the gross customer balances and commitments. The qualifying revolving retail exposures represent cards and overdrafts and the other non-SME represents loans.

Internal grades	**PD range %**	**Exposure value pre-CCF £m**	**Exposure at default £m**	**Average PD %**	**Average LGD %**	**RW %**	**RWA £m**
As at 30 June 2016							
Qualifying revolving retail exposures							
1	**0.00 to 0.04**	**91.8**	**424.3**	**0.04%**	**74.4%**	**2.2%**	**9.3**
2	**0.04 to 0.07**	**-**	**-**	**-**	**-**	**-**	**-**
3	**0.07 to 0.12**	**643.0**	**509.9**	**0.09%**	**80.6%**	**4.5%**	**22.9**
4	**0.12 to 0.31**	**513.6**	**257.7**	**0.22%**	**80.0%**	**9.9%**	**25.4**
5	**0.31 to 0.50**	**403.1**	**269.4**	**0.42%**	**79.9%**	**16.5%**	**44.4**
6	**0.50 to 1.00**	**99.6**	**77.8**	**0.70%**	**81.3%**	**25.1%**	**19.5**
7	**1.00 to 5.00**	**339.0**	**331.4**	**1.97%**	**79.4%**	**53.3%**	**176.5**
8	**5.00 to 10.00**	**64.3**	**66.1**	**5.73%**	**81.9%**	**117.5%**	**77.7**
9	**10.00 to 20.00**	**7.2**	**5.7**	**13.97%**	**81.0%**	**196.5%**	**11.2**
10	**20.00 to 50.00**	**7.0**	**5.9**	**39.76%**	**81.2%**	**272.9%**	**16.1**
11	**50.00 to 99.99**	**1.1**	**1.1**	**61.58%**	**83.0%**	**245.5%**	**2.7**
12	**100.00**	**28.7**	**28.7**	**100.00%**	**90.8%**	**56.1%**	**16.1**
Total Qualifying revolving retail		**2,198.4**	**1,978.0**	**2.31%**	**79.1%**	**21.3%**	**421.8**

exposures

Internal grades	PD range %	Exposure value pre-CCF £m	Exposure at default £m	Average PD %	Average LGD %	RW %	RWA £m
As at 31 December 2015							
Qualifying revolving retail exposures							
1	0.00 to 0.04	91.0	419.2	0.04%	74.5%	2.2%	9.2
2	0.04 to 0.07	-	-	-	-	-	-
3	0.07 to 0.12	719.9	562.0	0.09%	80.8%	4.5%	25.2
4	0.12 to 0.31	509.8	255.3	0.22%	80.1%	9.9%	25.2
5	0.31 to 0.50	378.4	300.7	0.44%	78.0%	16.5%	49.7
6	0.50 to 1.00	143.4	94.5	0.66%	83.3%	24.2%	22.9
7	1.00 to 5.00	309.1	278.3	2.31%	79.8%	59.2%	164.8
8	5.00 to 10.00	79.4	76.3	6.16%	82.7%	120.7%	92.1
9	10.00 to 20.00	14.3	11.9	13.15%	80.9%	184.9%	22.0
10	20.00 to 50.00	5.0	4.9	40.96%	79.1%	255.1%	12.5
11	50.00 to 99.99	1.9	1.9	60.58%	79.3%	210.5%	4.0
12	100.00	26.9	26.9	100.00%	89.4%	63.9%	17.2
Total Qualifying revolving retail exposures		2,279.1	2,031.9	2.26%	79.1%	21.9%	444.8

EAD has reduced by £53.9m (2.7%) in the period to 30 June 2016 driven by reductions in the Credit Card (£37.9m) and Overdraft (£16.0m) portfolios, resulting in lower RWAs. The PD model realignment exercise in May 2016 also contributed to the reduction in RWAs.

Internal grades	**PD range %**	**Exposure value pre-CCF £m**	**Exposure at default £m**	**Average PD %**	**Average LGD %**	**RW %**	**RWA £m**
As at 30 June 2016							
Retail other non-SME							
1	**0.00 to 0.04**	**-**	**-**	**-**	**-**	**-**	**-**
2	**0.04 to 0.07**	**-**	**-**	**-**	**-**	**-**	**-**
3	**0.07 to 0.12**	**-**	**-**	**-**	**-**	**-**	**-**
4	**0.12 to 0.31**	**0.4**	**0.4**	**0.27%**	**80.8%**	**50.0%**	**0.2**
5	**0.31 to 0.50**	**76.5**	**76.5**	**0.41%**	**81.2%**	**60.4%**	**46.2**
6	**0.50 to 1.00**	**0.1**	**0.1**	**0.58%**	**74.4%**	**67.4%**	**-**
7	**1.00 to 5.00**	**94.7**	**94.7**	**2.40%**	**79.6%**	**118.6%**	**112.2**
8	**5.00 to 10.00**	**7.6**	**7.6**	**9.11%**	**80.0%**	**152.6%**	**11.6**
9	**10.00 to 20.00**	**0.2**	**0.2**	**18.76%**	**78.8%**	**200.0%**	**0.4**
10	**20.00 to 50.00**	**6.7**	**6.7**	**34.31%**	**79.9%**	**240.3%**	**16.1**
11	**50.00 to 99.99**	**0.1**	**0.1**	**62.04%**	**74.4%**	**300.0%**	**0.3**
12	**100.00**	**66.3**	**66.3**	**100.00%**	**89.4%**	**89.6%**	**59.4**
Total Retail other non-SME		**252.6**	**252.6**	**28.51%**	**82.7%**	**97.5%**	**246.4**

Internal grades	PD range %	Exposure value pre-CCF £m	Exposure at default £m	Average PD %	Average LGD %	RW %	RWA £m
As at 31 December 2015							
Retail other non-SME							
1	0.00 to 0.04	-	-	-	-	-	-
2	0.04 to 0.07	-	-	-	-	-	-
3	0.07 to 0.12	-	-	-	-	-	-
4	0.12 to 0.31	0.7	0.7	0.27%	81.2%	42.9%	0.3
5	0.31 to 0.50	1.7	1.7	0.39%	81.2%	52.9%	0.9
6	0.50 to 1.00	-	-	-	-	-	-
7	1.00 to 5.00	196.3	196.3	1.77%	79.9%	96.7%	189.8
8	5.00 to 10.00	10.0	10.0	9.03%	79.7%	138.0%	13.8

9	10.00 to 20.00	0.9	0.9	17.55%	80.6%	177.8%	1.6
10	20.00 to 50.00	9.0	9.0	36.40%	79.5%	220.0%	19.8
11	50.00 to 99.99	0.4	0.4	62.79%	79.3%	225.0%	0.9
12	100.00	69.7	69.7	100.00%	89.3%	96.6%	67.3
Total Retail other non-SME		288.7	288.7	26.95%	82.2%	102.0%	294.4

EAD has reduced by £36.1m (12.6%) in the period to 30 June 2016, resulting in lower RWAs. The PD model realignment exercise in May 2016 also contributed to the reduction in RWAs.

Corporate credit risk

Overall, Corporate balances have reduced due to the on-going deleverage of the Non-core Corporate CoAM book. However, there has also been a transfer of assets from Corporate CoAM to BaCB comprising £250m of PFI and £100m of REAF. The risk of the Corporate book has been reduced due to the deleverage activity but the greater risk still remains within the Corporate CoAM book.

The key sectors in Corporate CoAM are PFI and Housing Associations and to a lesser extent Renewables. All three are characterised by low and stable credit risk and default rates. Commercial property investment is a key sector in both Corporate CoAM and BaCB. For the six months ended 30 June 2016 this sector was stable as a result of increased liquidity in the marketplace even for secondary assets.

Collateral

Property valuations are obtained when the facility is first approved and our lending procedures typically require collateral to be revalued every two years or more frequently in higher risk situations (typically annually or when a material change has occurred that is likely to affect the value and/or recoverability of the debt). Therefore, all collateral is based on pre EU referendum valuations.

The table below analyses the market value of the property collateral held against assets across all sectors:

	As at 30 June 2016			As at 31 December 2015		
	Exposure	**Collateral**	**Impairment provision**	Exposure	Collateral	Impairment provision
BaCB						
Non-default loans with ≤1 year until refinancing and all defaulted exposures regardless of term						
Less than 50%	**25.4**	**25.4**	**-**	27.9	27.9	-
50% to 60%	**7.9**	**7.9**	**-**	3.5	3.5	-
60% to 70%	**4.5**	**4.5**	**-**	1.0	1.0	-
70% to 80%	**-**	**-**	**-**	0.3	0.3	-
80% to 90%	**0.1**	**0.1**	**-**	-	-	-
90% to 100%	**-**	**-**	**-**	-	-	-
Greater than 100%	**0.7**	**0.6**	**-**	0.3	0.1	0.1
Unsecured	**39.3**	**-**	**0.8**	38.9	-	1.0
	77.9	**38.5**	**0.8**	71.9	32.8	1.1
Non-default loans with >1 year until refinancing and all non-loan non-defaulted exposures regardless of term						
Less than 50%	**230.2**	**230.2**	**-**	230.6	230.6	-
50% to 60%	**93.1**	**93.1**	**-**	86.7	86.7	-
60% to 70%	**67.4**	**67.4**	**-**	65.9	65.9	-
70% to 80%	**21.2**	**21.2**	**-**	10.6	10.5	-
80% to 90%	**5.3**	**5.3**	**-**	12.1	12.1	-
90% to 100%	**0.6**	**0.6**	**-**	0.7	0.7	-
Greater than 100%	**14.0**	**8.2**	**-**	20.2	12.8	0.1
Unsecured	**661.4**	**-**	**1.1**	234.0	-	0.6
	1,093.2	**426.0**	**1.1**	660.8	419.3	0.7
Total BaCB	**1,171.1**	**464.5**	**1.9**	732.7	452.1	1.8

	As at 30 June 2016			As at 31 December 2015		
	Exposure	**Collateral**	**Impairment provision**	Exposure	Collateral	Impairment provision
Corporate CoAM						
Non-default loans with ≤1 year until refinancing and all defaulted exposures regardless of term						
Less than 50%	**30.1**	**29.9**	**0.1**	34.6	34.3	0.3
50% to 60%	**35.0**	**35.0**	**-**	94.0	91.8	2.2
60% to 70%	**37.6**	**37.5**	**0.1**	33.0	26.4	6.6
70% to 80%	**6.5**	**6.5**	**-**	14.3	14.2	0.1

80% to 90%	**19.3**	**18.6**	**0.8**	20.9	16.8	4.0
90% to 100%	**4.9**	**4.4**	**0.5**	64.3	38.3	25.9
Greater than 100%	**111.2**	**41.9**	**59.0**	126.1	70.2	51.9
Unsecured	**46.3**	**-**	**22.6**	50.0	-	31.1
	290.9	**173.8**	**83.1**	437.2	292.0	122.1
Non-default loans with >1 year until refinancing and all non-loan non-defaulted exposures regardless of term						
Less than 50%	**320.0**	**319.9**	**-**	312.8	312.8	-
50% to 60%	**219.6**	**219.6**	**-**	367.8	367.8	-
60% to 70%	**281.5**	**281.5**	**-**	241.6	241.6	0.1
70% to 80%	**96.1**	**96.1**	**-**	142.9	142.9	-
80% to 90%	**61.1**	**61.0**	**0.1**	53.5	53.4	0.2
90% to 100%	**19.6**	**19.6**	**-**	24.4	24.4	-
Greater than 100%	**69.9**	**29.1**	**0.2**	62.1	27.3	0.1
Unsecured	**232.8**	**-**	**0.6**	715.7	-	3.4
	1,300.6	**1,026.8**	**0.9**	1,920.8	1,170.2	3.8
Total Corporate CoAM	**1,591.5**	**1,200.6**	**84.0**	2,358.0	1,462.2	125.9

Collateral is constrained to a maximum of 100% of the exposure to each customer to correctly reflect the maximum protection available to the Bank. For the purposes of determining capital and impairment appropriate forced sale discounts are applied to collateral.

BaCB balances (including commitments) increased by £438.4m (59.8%) in the period to 30 June 2016. This is driven by the transfer of low risk PFI and REAF assets from Corporate CoAM, leading to 156.8% increase in unsecured BaCB loans. Corporate CoAM balances (including commitments) reduced by £766.5m (32.5%) in the period to 30 June 2016, driven by the aforementioned transfer of assets to BaCB and non-performing asset sale and deleverage activity.

As at 30 June 2016, £4.5m (2015: £6.3m) of the above collateral is not held as first charge.

Impairment

Corporate customers may be treated as impaired when one or more of the defined impairment trigger events is evident. The impairment trigger events include but are not limited to loss of significant tenant; inability to refinance; significant financial difficulty; past due greater than 30 days; probable bankruptcy; granting of concessions or forbearance. Corporate cases are also placed on a watchlist and treated as impaired when they show signs of unsatisfactory performance and require close monitoring.

	As at 30 June 2016		As at 31 December 2015	
	BaCB	**Corporate CoAM**	BaCB	Corporate CoAM
Gross loans and advances	**893.9**	**1,503.7**	549.4	2,176.9
of which impaired	**24.1**	**234.6**	32.8	354.1
Impaired as a % of gross loans and advances	**2.7%**	**15.6%**	6.0%	16.3%
Allowance for losses	**1.9**	**84.0**	1.0	118.4
Coverage	**7.9%**	**35.8%**	3.0%	33.4%

The Bank manages recovery of customer arrears on a gross customer balance basis (excluding credit fair value adjustments and other accounting entries).

BaCB gross loans and advances increased in the period to 30 June 2016 primarily due to the transfer of performing assets from Corporate CoAM, which reduces the impaired percentage considerably from 6.0% to 2.7%. Corporate CoAM gross loans and advances reduced by £673.2m (30.9%), with impaired balances reducing by £119.5m (33.7%). Total allowance for losses reduced by £34.4m mainly due to the non-performing asset sale in June 2016 alongside a smaller release due to the refresh of collective provision parameters, deleverage of assets and release in good book fair value all contributing to a reduction in Corporate CoAM collective allowance for losses.

The movements in impaired customer balances during the period are shown below:

	As at 30 June 2016		As at 31 December 2015	
	BaCB	**Corporate CoAM**	BaCB	Corporate CoAM
Balance at start of year	**32.8**	**354.1**	26.7	1,216.0
Classified as impaired during the period	**5.7**	**25.9**	27.9	118.0
Transferred to unimpaired during period	**(4.8)**	**(17.8)**	(8.0)	(111.1)
Amounts written off	**-**	**(42.5)**	-	(363.1)
Net repayments and other	**(9.6)**	**(85.1)**	(13.8)	(505.7)
Balance at the end of the period	**24.1**	**234.6**	32.8	354.1

Forbearance

If the Bank is confident of a customer's ability and commitment to address their financial difficulties, it may agree to grant concessions to the original contractual terms. Impairment provisions are recognised on accounts, which are in default and on the watchlist, subject to forbearance.

The table below analyses the exposures subject to forbearance:

	As at 30 June 2016			As at 31 December 2015		
	Forborne	**Non-forborne**	**Total**	Forborne	Non-forborne	Total
BaCB						
Default	**-**	**2.1**	**2.1**	-	7.2	7.2
On watch list	**7.5**	**17.3**	**24.8**	3.7	24.9	28.6
Neither default nor on watch list	**-**	**1,144.2**	**1,144.2**	1.4	695.5	696.9
Total BaCB	**7.5**	**1,163.6**	**1,171.1**	5.1	727.6	732.7
Corporate CoAM						
Default	**95.8**	**88.2**	**184.0**	102.4	201.5	303.9
On watch list	**24.2**	**28.4**	**52.6**	31.1	33.2	64.3
Neither default nor on watch list	**-**	**1,354.9**	**1,354.9**	11.8	1,978.0	1,989.8
Total Corporate CoAM	**120.0**	**1,471.5**	**1,591.5**	145.3	2,212.7	2,358.0
Total BaCB and Corporate CoAM	**127.5**	**2,635.1**	**2,762.6**	150.4	2,940.3	3,090.7

Foundation IRB uses modelled PD and regulatory defined amounts for Loss Given Default (LGD). Credit ratings are derived from a variety of information sources including ECAI's Moody's and Fitch, based on fundamental credit analysis to assign an appropriate internal rating grade (IRG) 1-9. More conservative, qualitative overlays to counterparties IRG (downward overrides) may be applied with the supporting credit rationale clearly stated in the appropriate credit review.

Corporate foundation IRB EAD by PD band

The table below analyses Corporate exposure by Probability of Default (PD) band and discloses average risk weight percentage for exposures subject to the foundation IRB approach.

Internal grades	**PD range %**	**Mapped external rating**	**Exposure value at pre-CCF £m**	**Exposure at default £m**	**Average PD %**	**Average LGD %**	**RW %**	**RWA £m**
As at 30 June 2016								
1	**0.00 to 0.03**	**A**	**-**	**-**	**-**	**-**	**-**	**-**
2	**0.03 to 0.06**	**A-**	**13.7**	**12.0**	**0.05%**	**45.0%**	**25.0%**	**3.0**
3	**0.06 to 0.16**	**BBB+**	**573.1**	**568.0**	**0.14%**	**36.4%**	**41.3%**	**234.4**
4	**0.16 to 0.26**	**BBB**	**265.2**	**258.1**	**0.22%**	**38.3%**	**54.9%**	**141.8**
5	**0.26 to 0.40**	**BBB-**	**144.0**	**128.2**	**0.33%**	**43.4%**	**76.2%**	**97.7**
6	**0.40 to 0.65**	**BBB-**	**22.6**	**21.2**	**0.51%**	**38.1%**	**58.5%**	**12.4**
7	**0.65 to 1.10**	**BB+**	**15.6**	**14.5**	**0.85%**	**40.3%**	**84.8%**	**12.3**
8	**1.10 to 1.90**	**BB**	**25.2**	**24.0**	**1.50%**	**41.8%**	**108.8%**	**26.1**
9	**1.90 to 3.30**	**BB-**	**4.6**	**4.2**	**3.00%**	**41.0%**	**97.6%**	**4.1**
10	**3.30 to 10.00**	**B**	**29.4**	**24.6**	**6.00%**	**41.3%**	**139.8%**	**34.4**
11	**10.00 to 15.00**	**B-**	**8.0**	**7.9**	**13.00%**	**37.9%**	**159.5%**	**12.6**
12	**15.00 to 20.00**	**CCC+**	**0.1**	**0.1**	**18.00%**	**45.0%**	**200.0%**	**0.2**
13	**20.00 to 99.99**	**CCC**	**0.6**	**0.6**	**22.00%**	**37.5%**	**216.7%**	**1.3**
14	**100.00**	**Default**	**9.1**	**9.0**	**100.00%**	**42.9%**	**-**	**-**
Total Corporates			**1,111.2**	**1,072.4**	**1.32%**	**38.2%**	**54.1%**	**580.3**

Internal grades	PD range %	Mapped external rating	Exposure value at pre-CCF £m	Exposure at default £m	Average PD %	Average LGD %	RW %	RWA £m
As at 31 December 2015								
Corporates								
1	0.00 to 0.03	A	-	-	-	-	-	-
2	0.03 to 0.06	A-	-	-	-	-	-	-
3	0.06 to 0.16	BBB+	605.1	571.9	0.14%	35.9%	42.5%	243.0
4	0.16 to 0.26	BBB	290.0	280.8	0.22%	37.3%	52.6%	147.8
5	0.26 to 0.40	BBB-	171.2	154.0	0.33%	43.5%	68.5%	105.5

6	0.40 to 0.65	BBB-	26.3	24.6	0.51%	38.1%	59.3%	14.6
7	0.65 to 1.10	BB+	27.6	26.0	0.85%	41.4%	74.6%	19.4
8	1.10 to 1.90	BB	21.3	19.9	1.50%	42.8%	114.6%	22.8
9	1.90 to 3.30	BB-	9.5	9.0	3.00%	40.1%	100.0%	9.0
10	3.30 to 10.00	B	30.9	29.6	6.00%	39.2%	125.0%	37.0
11	10.00 to 15.00	B-	3.1	3.1	13.00%	44.9%	206.5%	6.4
12	15.00 to 20.00	CCC+	0.1	0.1	18.00%	45.0%	200.0%	0.2
13	20.00 to 99.99	CCC	0.6	0.6	22.00%	37.8%	200.0%	1.2
14	100.00	Default	32.9	32.6	100.00%	40.4%	-	-
Total Corporates			1,218.6	1,152.2	3.28%	37.8%	52.7%	606.9

EAD has reduced by £79.8m primarily driven by Corporate CoAM deleverage. Average PD has also decreased in the period to 30 June 2016 to 1.32% (2015: 3.28%) driven by a reduction in default exposures.

2.2.2 Investment securities

There have been no changes to policies regarding investment securities, collateral management or impairment of investment securities during the first half of 2016. The Bank only invests in Treasury assets which comply with the Credit Risk Policy and Treasury Credit Risk Control Standard. Within the Treasury investment security portfolio all exposures had an external credit rating equivalent to Fitch A or above at the end of June 2016.

2.2.3 Loans and advances to banks

None of the Bank's exposures in terms of loans and advances to banks are impaired. The Bank considers that these exposures are all of low to medium risk.

2.2.4 Derivative financial instruments

During the first half of 2016 the Bank continued to clear all new derivative transactions through a central clearing counterparty. The Bank also sought agreement from a number of counterparties to re-book existing derivative transactions through its central clearing counterparty. In accordance with IFRS 13 the credit value adjustment (CVA) is £3.4m (31 December 2015: £3.2m).

2.2.5 Wholesale credit risk

The composition of Treasury credit risk exposures remained broadly unchanged during the first half of 2016. Exposure to the UK government continues to make up two thirds of all exposures, excluding MBS. The only material non-UK sovereign debt exposure remained to the Government of Finland but this was reduced to £89.0m as at 30 June 2016 compared with £194.0m as at 31 December 2015.

Treasury foundation IRB EAD by PD Band

The table below analyses exposures by Probability of Default (PD) band and discloses average risk weight percentage for exposures subject to the foundation IRB approach. Assets rated using the Foundation IRB rating approach include the following exposures: Loans and Advances to Banks, Derivative Financial Instruments and Repurchase Transactions (Repos).

Foundation IRB uses modelled PD and regulatory defined amounts for LGD. Credit ratings are derived from a variety of information sources including ECAI's Moody's and Fitch based on fundamental credit analysis to assign an appropriate IRG 1-9. More conservative, qualitative overlays to counterparties IRG (downward overrides) may be applied with the supporting credit rationale clearly stated in the appropriate credit review.

Internal grades	PD range %	Mapped external rating	Exposure value at pre-CCF £m	Exposure at default £m	Average PD %	Average LGD %	RW %	RWA £m
As at 30 June 2016								
Institutions								
1 / 2	**0.00 to 0.04**	**AAA to AA**	**91.9**	**91.9**	**0.03%**	**45.0%**	**10.9%**	**10.0**
3	**0.04 to 0.06**	**AA-**	**365.9**	**251.4**	**0.05%**	**45.0%**	**27.7%**	**69.7**
4	**0.06 to 0.08**	**A+**	**-**	**-**	**-**	**-**	**-**	**-**
5	**0.08 to 0.20**	**A**	**621.7**	**322.1**	**0.09%**	**45.0%**	**25.4%**	**81.7**
6	**0.20 to 0.30**	**A- to BBB+**	**587.2**	**105.7**	**0.28%**	**45.0%**	**50.7%**	**53.6**
7	**0.30 to 1.00**	**BBB to BBB-**	**15.5**	**1.8**	**0.66%**	**45.0%**	**88.9%**	**1.6**
8	**1.00 to 5.00**	**BB+ to BB-**	**0.1**	**0.1**	**2.04%**	**45.0%**	**100.0%**	**0.1**
9	**5.00 to 99.99**	**B+ to C**	**-**	**-**	**-**	**-**	**-**	**-**
10	**100.00**	**Default**	**-**	**-**	**-**	**-**	**-**	**-**
Total Institutions			**1,682.3**	**773.0**	**0.10%**	**45.0%**	**28.0%**	**216.7**

	PD range	Mapped	Exposure	Exposure at	Average PD	Average LGD	RW	RWA

Internal grades	%	external rating	value at pre-CCF £m	default £m	%	%	%	£m
As at 31 December 2015								
Institutions								
1 / 2	0.00 to 0.04	AAA to AA	25.8	25.8	0.03%	45.0%	10.9%	2.8
3	0.04 to 0.06	AA-	404.9	335.8	0.05%	45.0%	21.2%	71.2
4	0.06 to 0.08	A+	-	-	-	-	-	-
5	0.08 to 0.20	A	491.8	364.8	0.10%	45.0%	27.0%	98.4
6	0.20 to 0.30	A- to BBB+	345.3	109.3	0.28%	45.0%	43.8%	47.9
7	0.30 to 1.00	BBB to BBB-	0.2	0.2	0.66%	45.0%	50.0%	0.1
8	1.00 to 5.00	BB+ to BB-	0.1	0.1	2.04%	45.0%	100.0%	0.1
9	5.00 to 99.99	B+ to C	-	-	-	-	-	-
10	100.00	Default	-	-	-	-	-	-
Total institutions			1,268.1	836.0	0.10%	45.0%	26.4%	220.5

3. Liquidity risk

The Bank's management of liquidity and funding risk aims to ensure that at all times there are sufficient liquid resources, both as to amount and quality to cover cash flow mismatches and fluctuations in the Bank's funding profile in order to meet financial obligations as they fall due even during periods of stress. This is achieved through the management and stress testing of the Bank's cash flows and the setting of appropriate risk limits to maintain a prudent funding mix, maturity profile and level of high quality liquid assets.

To manage its liquidity and funding risk the Bank monitors the following: funding and cashflow profile, maturity concentrations, total liquid asset portfolio, asset encumbrance, stress testing, assessing market conditions for stress and contingency planning.

The Bank has an established funding base, predominantly comprising Retail and Corporate deposits. The Bank closely monitors and manages its liquidity position, maintaining a regulatory liquidity buffer appropriate for the Bank's funding profile in order to ensure the Bank meets its financial obligations as and when they fall due. As at 30 June 2016 the Bank's liquid asset ratio is 12.7% (2015: 15.6%) and the Bank has a Liquidity Coverage Ratio (LCR) in excess of 100% compared to Pillar 1 and Pillar 2 requirements.

3.1 Liquidity Risk Management Framework and risk policies

Liquidity management information is provided on a regular basis to the Liquidity & Market Risk Forum (LMRF), ALCO and the Board which details the Bank's compliance with its core liquidity risk metrics, which include:

• customer loan/deposit ratio, 88.7% (2015: 86.3%) – the ratio of customer loans (excluding credit commitments) to customer deposits;

• encumbrance ratio- 18.2% (2015: 21.8%) – per the EBA definition, asset encumbrance ratio = (carrying amount of encumbered assets and collateral)/(total assets and collateral), where an asset is considered as encumbered if it has been pledged or if it is subject to any form of arrangement to secure, collateralise or credit enhance any transaction from which it cannot be freely withdrawn; and

• internal liquidity stress tests – the survival period of the Bank under an applicable stress scenario. The Bank held a buffer in excess of the requirements from the applicable stress scenario at 30 June 2016.

3.2 Liquid asset portfolios

Total liquidity resources as at 30 June 2016 were £8,868.1m (2015: £10,247.1m). The Bank is focused on maintaining a high percentage of liquid assets which are high-quality and the table below analyses the Bank's liquidity portfolio by product and unencumbered liquidity value. The Bank categorises its liquidity portfolio into primary and secondary (other liquid assets and contingent liquidity).

Primary liquid assets includes cash and balances at central banks, gilts and other high quality government bonds.

Secondary liquidity comprises of liquid investment securities not included as part of primary liquidity as well as other forms of contingent liquidity sources. In the 2015 Annual Report and Accounts contingent liquidity included all other non-primary liquid assets. The Bank has now narrowed this definition in the statutory accounts to only include assets (excluding other liquid assets) eligible for central bank facilities immediately available for use at the central bank and therefore the 2015 comparatives have been restated to align with this change.

	As at 30 June 2016	(Restated) As at 31 December 2015
Operational balances with central banks	**2,056.6**	2,329.3
Gilts	**949.6**	1,450.2
Central government and multilateral development bank bonds	**587.1**	760.2
Total primary liquid assets	**3,593.3**	4,539.7
Other liquid assets	**1,007.8**	1,386.6
Contingent liquidity	**4,267.0**	4,320.8

Total liquidity	**8,868.1**	10,247.1
Average balance	**9,402.4**	11,107.5

The Bank uses a combination of these asset pools to manage liquidity, with primary liquidity used predominantly for short term cash flow movements, while other liquidity is used for creating longer term liquidity. Regular realisation through repo transactions and outright sales provide assurance that these asset pools remain sufficiently liquid. Liquid assets have reduced in the period in line with a reduction in the liquidity risk profile since the year end.

Included within the primary liquid asset balance above is £191.4m of UK government gilts obtained through a collateral upgrade transaction. In accordance within the recognition criteria for financial assets under IAS 39, these gilts are not recognised on the Bank's balance sheet.

Wholesale funding

Wholesale funding is used to supplement retail and commercial deposits to diversify the source of funds to support the business plan of the Bank. The Bank has a variety of long term wholesale funding sources outstanding, including securitisations, covered bond and medium term notes, as shown in the table below:

	As at 30 June 2016	As at 31 December 2015
Preference shares and subordinated debt	**468.2**	457.0
Secured funding	**1,820.3**	2,091.0
Repos	**638.6**	671.3
Market borrowing	**1.6**	10.9
MTNs	**405.0**	404.9
Total wholesale funding	**3,333.7**	3,635.1

The reduction in wholesale funding reflects the repayment of secured funding in the period. Gilt repos make up £523.5m of total repo funding.

The following table sets out the Bank's contractual wholesale funding by maturity, with the Leek notes and Silk 3 being disclosed based on call dates:

	As at 30 June 2016	As at 31 December 2015
Repayable in less than 1 month	**525.1**	522.5
Repayable between 1 and 3 months	**203.7**	159.7
Repayable between 3 and 6 months	**483.8**	352.4
Repayable between 6 and 9 months	**-**	243.3
Repayable between 9 and 12 months	**493.6**	433.0
Repayable between 1 and 2 years	**424.2**	746.9
Repayable between 2 and 5 years	**269.8**	259.0
Repayable in more than 5 years	**933.5**	918.3
Total external funding	**3,333.7**	3,635.1

3.3 Encumbrance

An asset is defined as encumbered if it has been pledged as collateral against an existing liability or to collateralise an exposure that the Bank may have, restricting access to that asset in the event of resolution or bankruptcy. An encumbered asset would be no longer available to the Bank for use in secured funding, to satisfy collateral needs or to be sold to reduce the funding requirement. The encumbrance table is presented based on median values of the last four quarters and therefore will not correspond to the balance sheet asset total which is presented on a point-in-time basis. The 31 December 2015 table has been re-presented on this basis.

	Encumbered Assets				**Unencumbered Assets**	
As at 30 June 2016	**As a result of covered bonds**	**As a result of securitisations**	**Other**	**Total**		**Total**
Equity investments	**-**	**-**	**-**	**-**	**49.8**	**49.8**
Debt securities	**-**	**495.5**	**958.8**	**1,454.3**	**3,042.0**	**4,496.3**
Other assets	**1,225.9**	**1,784.6**	**1,631.9**	**4,642.4**	**19,648.1**	**24,290.5**
Assets of the reporting institution	**1,225.9**	**2,280.1**	**2,590.7**	**6,096.7**	**22,739.9**	**28,836.6**

	Encumbered Assets				Unencumbered Assets	
Re-presented As at 31 December 2015	As a result of covered bonds	As a result of securitisations	Other	**Total**		**Total**
Equity investments	-	-	-	**-**	2.7	**2.7**
Debt securities	-	481.0	1,310.5	**1,791.5**	3,046.6	**4,838.1**
Other assets	1,288.3	1,872.1	2,173.6	**5,334.0**	22,497.5	**27,831.5**
Assets of the reporting institution	1,288.3	2,353.1	3,484.1	**7,125.5**	25,546.8	**32,672.3**

4. Market risk
Market risk is the risk of loss as a result of the value of financial assets or liabilities (including off-balance sheet instruments) being adversely affected by movements in market rates or prices. This loss can be reflected in the near term earnings by changing net interest income, or in the longer term because of changes in the economic value of future cash flows.

The main source of market risk within the Bank is driven by mismatches between the re-pricing profiles of asset and liability customer products and certain characteristics embedded within these products and basis risk. Whilst the Bank does not have a trading book, the Treasury function does create both market risk and currency risk through its various portfolio management activities and employs risk management strategies designed to ensure stability of earnings.

The Bank does not does not have any Pillar 1 market risk requirement as it does not operate a trading book and its net currency positions are below the required threshold. All market risk exposures are addressed under the PRA's Pillar 2 framework, which is captured as part of its ICG requirement.

Market risk exposures have been maintained well within the Bank's risk appetite which has remained unchanged from the end of 2015, as do the primary drivers of market risk. Interest rate risk when expressed in terms of PV01 averaged £67k during the first half of 2016 with a low of £22k and a high of £112k. A reduction in the holding of hedged UK government bonds has contributed to reduced swap spread risk which has fallen to a PV01 of £891k (31 December 2015: £1,041k). There has also been a similar reduction in the Bank's Credit Risk exposures which primarily reflect holdings in Warwick Finance One and Warwick Finance Two securitisations. A combination of repayments and outright sale has seen the notional holding of MBS fall from £1,614.0m at 31 December 2015 to £1,414.0m at 30 June 2016.

5. Capital management
Capital is held by the Bank to protect its depositors, to cover its inherent risks, to absorb unexpected losses, and to support the development of the business.

The Bank manages and calculates its capital in accordance with CRD IV, implemented in the European Union through publication of Capital Requirements Regulation (CRR) and a further iteration of the Capital Requirements Directive (CRD). Together this package of requirements is known as CRD IV and came into force from 1 January 2014. The European Banking Authority is providing technical standards relating to CRD IV, some of which are not yet finalised. CRD IV disclosures in this document are based on the Bank's interpretation of published rules.

All CRD IV disclosures are shown on a fully loaded basis as the Bank no longer has any applicable minority interests following the sale of the Bank's majority shareholding in Unity Trust Bank.

Throughout H1 2016 the Bank has continued to make progress towards improving its capital position and reducing its overall risk profile. Non-core RWAs have reduced to £2.0bn from £2.8bn due to continued deleveraging activity in Corporate CoAM but also due to a transfer of performing assets from Corporate CoAM to BaCB. In line with the Bank's Plan, Core RWAs have increased by £0.5bn.

The Bank is seeking to enhance its credit modelling capability in a number of key portfolios and is in discussion with the PRA with regards to the approval and implementation of these enhancements during 2017.

The Bank continues to meet its Pillar 1 capital requirements under normal economic conditions. This is the minimum required under the CRR. The PRA provides ICG for each bank, this represents guidance on the capital (Pillar 2a) a firm should hold in excess of Pillar 1.

Through most of 2015, the Bank was compliant with its ICG. However, due to the ongoing losses the Bank breached its ICG in H1 2016. It is expected that the Bank will meet ICG by the end of the plan.

The Bank does not currently have sufficient capital resources to withstand a severe stress scenario under its current in force PRA Buffer. The Bank expects to build a buffer by the end of the planning period however, given the recent announcement from the Bank of England regarding the relaxation of PRA Buffer and the uncertainty about how this measure will now evolve over the planning horizon, the Bank cannot conclude on whether its expected ICG surplus at the end of the plan would be sufficient to result in a surplus position to the in force PRA buffer at that time.

The Bank is mindful of the capital implications of the Bank of England's MREL regime and the increased debt issuance this will drive, for the banking industry in general but also for the Bank.

The Bank of England published a consultation paper in December 2015 proposing a methodology for setting a firm's individual MREL requirement equivalent to 2 x (Pillar 1 + Pillar 2a) depending on the resolution complexity of the individual firm, and as specified in the consultation paper, the Bank of England may make further amendments to the methodology.

The Bank's Updated Plan (2016-2020) incorporates MREL qualifying issuance commencing in 2018 which is the Board's current view of the earliest time when such issuance may be feasible. The PRA and the Bank of England have indicated their strong preference that the Bank incorporates an earlier profile of MREL issuance than currently contemplated by the Bank's Updated Plan. Such expectations have been confirmed by the Regulators as not intended yet to represent the formal setting of a required MREL issuance plan and the Bank of England has stated that it will consult with the Bank before setting binding requirements, which it will be able to do at any point following publication of its MREL policy (expected to be sometime in 2016). Refer to the Principal Risk and Uncertainties section for further detail on MREL.

Key capital highlights are:

- Fully-loaded CET1 ratio has decreased to 13.4% as at 30 June 2016 (31 December 2015: 15.5%) with a decrease in risk weighted assets of £0.2bn and a reduction in CET1 of £0.2bn.

- Fully-loaded leverage ratio has decreased to 3.4% as at 30 June 2016 (31 December 2015: 3.8%) reflecting a decrease in Tier 1 of £0.2bn and a reduction in exposure of £1.4bn.

- At 31 December 2015, the Bank was compliant with its ICG, being the PRA's statement as to the regulatory capital it expects the Bank to hold. However, due to the Bank's ongoing losses, as anticipated in the Updated Plan, the Bank breached its ICG in H1 2016. The Bank met the Pillar 1 requirement throughout the period.

- It is expected that the Bank will meet ICG by the end of the plan and will remain above the CET1 ratio regulatory minimum at all times. The plan aims to build a sustainable Core Bank and is designed to create a capital buffer by the end of the plan, however, the Bank cannot conclude on whether its expected ICG surplus at the end of the plan would be sufficient to result in a surplus position to the in force PRA buffer at that time. The Bank's leverage ratio is expected to be sustainably 3.0% or greater by the end of the plan, however, it is expected to reduce in the intervening period.

5.1 Risks
For more information on the risks facing the Bank see Principal Risks and Uncertainties section and note 1.

5.2 Capital resources CRD IV

	30 June 2016 fully-loaded	31 December 2015 fully-loaded
Common Equity Tier 1 (CET1): instruments and reserves		
Permanent share capital and the related share premium account	**1,759.5**	1,759.5
Retained earnings	**(896.4)**	(273.1)
Available for sale and cash flow hedge reserves	**95.3**	90.2
Other Reserves[1]	**470.5**	410.0
CET1 before regulatory adjustments	**1,428.9**	1,986.6
CET1: regulatory adjustments		
Prudential valuation in trading book	**(2.3)**	(0.8)
Intangible assets (net of related tax liability)	**(140.6)**	(142.8)
Defined Benefit Pension reserve net of deferred tax liability	**(60.5)**	
Deferred tax assets not arising from temporary differences	**(7.1)**	(4.0)
Cash flow hedge reserves	**(85.2)**	(34.6)
Expected loss shortfall	**(33.6)**	(30.0)
Losses for the period [2]	**(132.1)**	(623.3)
Total regulatory adjustments to CET1	**(461.4)**	(835.5)
CET1	**967.5**	1,151.1
Additional Tier 1 (AT1) capital: instruments	**-**	-
Total regulatory adjustments to AT1 capital	**-**	-
Total Tier 1 capital (T1 = CET1 +AT1)	**967.5**	1,151.1
Tier 2 (T2) capital: instruments and provisions		
Capital instruments	**446.2**	448.4
Credit risk adjustments	**3.7**	-
T2 capital before regulatory adjustments	**449.9**	448.4
Total regulatory adjustments to T2 capital	**-**	-
T2 capital	**449.9**	448.4
Total capital (TC = T1 + T2)	**1,417.4**	1,599.5

1. Other reserves includes the capital redemption reserve created as a result of the Bank's Liability Management Exercise in 2013, and the defined benefit pension reserve created in 2016.
2. A reconciliation of statutory to regulatory loss for the year is included in section 5.6.

5.3 Capital ratios and Risk Weighted Assets

	30 June 2016 fully-loaded	31 December 2015 fully-loaded
Capital ratios		
Common Equity Tier 1 ratio	**13.4%**	15.5%
Tier 1 ratio	**13.4%**	15.5%
Total capital ratio	**19.7%**	21.6%

Risk weighted assets		
Credit risk	**6,471.6**	6,517.6
Market risk	**-**	-
Operational risk	**732.1**	905.3
Total risk weighted assets	**7,203.7**	7,422.9

Segmental analysis of credit risk weighted assets		
Core		
Retail	**1,869.5**	1,810.9
BaCB	**888.6**	496.8
Treasury/other	**1,674.2**	1,440.8
Total Core	**4,432.3**	3,748.5
Non-core		
Corporate CoAM	**1,126.5**	1,793.1
Optimum	**912.8**	976.0
Total Non-core	**2,039.3**	2,769.1
Total credit Risk Weighted Assets	**6,471.6**	6,517.6

Fully-loaded CET1 ratio has decreased to 13.4% from 15.5% as at 31 December 2015. This reflects a reduction in CET1 of £0.2bn and a decrease in risk weighted assets of £0.2bn. The move in CET1 reflects a £132.1m regulatory loss for the year.

Overall RWAs have decreased by £0.2bn from 31 December 2015.

Non-core RWAs have reduced by £0.7bn, driven mainly by a transfer of Corporate CoAM assets to BaCB and continued deleverage of the Corporate CoAM portfolio. The Bank continues to monitor its ability to undertake any further securitisations of the Optimum portfolio however, as it remains a closed book, a £0.1bn reduction in RWAs has occurred.

Total Core RWAs which includes Core Credit Risk and Operational Risk RWAs have increased to £5.2bn (31 December 2015: £4.7m). Core Credit Risk RWAs have increased by £0.7bn primarily driven by the transfer of business from Corporate CoAM described above coupled with an overall increase in the mortgage portfolio. Operational Risk RWAs have decreased by £0.2bn following the annual recalculation of the Pillar 1 operational risk requirement subsequent to the 2015 year end results.

5.4 Pillar 1 capital requirements and Risk Weighted Assets

The following table analyses the Pillar 1 capital requirement by approach and exposure class. In the table below and throughout the document, unless otherwise stated, the documented exposures are reported as exposure at default (EAD). For IRB exposures EAD is defined as the amount estimated to be outstanding at the time of default, including the estimation of credit conversion factors to undrawn commitments. For standardised exposures EAD includes undrawn commitments post credit conversion factors defined in CRR Article 111 and is net of eligible provision.

In accordance with CRR Article 150 (Conditions for permanent partial use) the Bank has received permission from the Regulator to exempt its exposures to certain counterparty classes, namely central governments and central banks and multilateral development banks from the IRB approach for the purposes of the calculation of both risk weighted exposure and expected loss amounts, instead applying the standardised approach for these exposures. The revised approach was implemented for the purposes of the Bank's regulatory reporting submissions as of 1 January 2014.

The exposure classes not applicable to the Bank and which haven't been presented in the tables disclosing exposures classes throughout this document, are as follows:

- IRB approach: Central government and central bank, Retail SME, Equity exposures and Other non-credit obligation assets; and

- Standardised approach: International organisations, Securitisation positions, Exposures associated with particularly high risks, Short term claims on institutions and corporates and Collective investment undertakings.

The following table analyses the capital requirements by approach and exposure class:

As at 30 June 2016	Capital requirement	Risk weighted assets	Exposure at default	Average risk weight	Average exposure at default
IRB exposure class	£m	£m	£m	%	£m
Institutions	17.3	216.7	773.0	28.0%	841.8
Corporates	46.4	580.3	1,072.4	54.1%	1,127.0
Retail secured by immovable property	165.0	2,063.1	15,906.9	13.0%	15,726.7
Qualifying revolving retail exposures	33.7	421.8	1,978.0	21.3%	2,004.3
Retail other non-SME	19.7	246.4	252.6	97.5%	272.5
Securitisation positions	48.7	608.5	2,764.3	22.0%	2,949.5
Total IRB	330.8	4,136.8	22,747.2	18.2%	22,921.8
Specialised lending	89.3	1,116.6	1,339.2	83.4%	1,428.5
Standardised exposure class					
Central government or central banks	-	-	4,169.5	0.0%	4,680.7
Regional governments or local authorities	-	0.6	2.8	21.4%	3.9
Public sector entities	0.3	3.8	19.0	20.0%	19.5
Multilateral development banks	-	-	499.3	0.0%	530.6
Institutions	10.7	133.5	56.9	234.6%	75.6
Corporates	22.8	284.9	284.9	100.0%	298.0
Retail exposures	3.9	48.6	64.8	75.0%	72.1
Secured by mortgages on immoveable property[1]	-	0.1	0.2	75.0%	0.2
Exposures in default	2.5	31.2	23.3	133.9%	35.3
Covered bonds	-	-	-	0.0%	-
Equity exposures	4.7	59.1	50.0	118.2%	59.2
Other items[2]	52.5	656.4	655.4	100.2%	595.4
Total standardised	97.4	1,218.2	5,826.1	20.9%	6,370.5
Total credit risk	517.5	6,471.6	29,912.5	21.6%	30,720.8
Total market risk	-	-	N/a	N/a	N/a
Operational risk	58.6	732.1	N/a	N/a	N/a
Total Pillar 1	576.1	7,203.7	N/a	N/a	N/a

1. The standardised Secured by mortgages on immovable property class contains a small number of legacy mortgages not included within the IRB portfolio. The 75% RW% is accurate; however, due to the small level of exposure rounded values do not allow arithmetic calculations in the table.
2. Other items relate to accounting adjustments applied to customer balances and investments, and non-customer related assets on the balance sheet (e.g. cash, property, plant & equipment and tax). The varying risk weights applied to these assets under CRR drive the average risk weight.

Institutions calculated under the standardised approach include £107.3m of RWAs and £8.6m capital requirement relating to the calculation of Credit Fair Value adjustments for derivatives.

5.5 Reconciliation of equity per balance sheet to total capital as at 30 June 2016

Balance sheet presentation	Balance per accounts	Regulatory presentation	Regulatory Balance treatment	Cash flow hedge reserve	Defined Benefit Pension net of associated deferred liabilities	Regulatory treatment of deferred tax assets	Expected losses	Prudent valuation in trading book	Capital Resources Transitional Rules
		Equity							
Ordinary share capital	22.6	Paid up capital instruments	22.6	-	-	-	-	-	22.6
Share premium account	1,736.9	Share Premium	1,736.9	-	-	-	-	-	1,736.9
Retained earnings	(1,028.5)	Retained earnings	(896.4)	-	-	-	-	-	(896.4)
		Regulatory losses for the period	(132.1)	-	-	-	-	-	(132.1)
Available for sale reserve	10.1	Available for sale reserve	10.1	-	-	-	-	-	10.1

Cash flow hedging reserve	**85.2**	Cash flow hedging reserve	**85.2**	**(85.2)**	**-**	**-**	**-**	**-**	**-**
Capital redemption reserve	**470.5**	Other reserves	**470.5**	**-**	**(60.5)**	**-**	**-**	**-**	**410.0**
		Total Equity	**1,296.8**	**(85.2)**	**(60.5)**	**-**	**-**	**-**	**1,151.1**
		Non-Equity							
Other borrowed funds	**446.2**	Capital instruments	**446.2**	**-**	**-**	**-**	**-**	**-**	**446.2**
Intangible assets	**(140.6)**	Intangible assets (net related tax liability)	**(140.6)**	**-**	**-**	**-**	**-**	**-**	**(140.6)**
Deferred tax assets	**0.3**	Deferred tax assets not arising from temporary differences	**0.3**	**-**	**-**	**(7.4)**	**-**	**-**	**(7.1)**
Credit value adjustment[1]	**(207.9)**	Expected loss shortfall	**204.2**	**-**	**-**	**-**	**(237.8)**	**-**	**(33.6)**
		Expected loss Tier 3 add-back	**3.7**	**-**	**-**	**-**	**-**	**-**	**3.7**
		Prudent valuation	**-**	**-**	**-**	**-**	**-**	**(2.3)**	**(2.3)**
		Total Non-Equity	**513.8**	**-**	**-**	**(7.4)**	**(237.8)**	**(2.3)**	**266.3**
		Total balances subject to own funds calculations	**1,810.6**	**(85.2)**	**(60.5)**	**(7.4)**	**(237.8)**	**(2.3)**	**1,417.4**

1.Credit risk adjustments are made up of impairment provision and credit related fair value, relating to exposures calculated under the IRB approach to credit risk which are applicable for the calculation of EL gap per CRR. Therefore the impairment number included in the table above relates to IRB exposures only, and is a subset of the Bank's total impairment and fair value

5.6 Reconciliation of statutory to regulatory loss for the period

	Period to 30 June 2016	Year to 31 December 2015
Statutory loss for the period	**(132.1)**	(622.8)
Statutory loss attributable to minority shareholders	**-**	(0.5)
Discounted cash flows for ordinary shares not recognised until cash consideration paid	**-**	-
Regulatory loss for the period	**(132.1)**	(623.3)

5.7 On-balance sheet exposure reconciliation

The table shows the reconciliation of EAD to the leverage measure of exposure:

	As at 30 June 2016 £m
Total EAD	**29,912.4**
Derivative exposures	**(424.2)**
Securities financing transactions	**(113.3)**
Off-balance sheet items EAD	**(2,068.1)**
IRB Provisions for on-balance sheet items	**(195.2)**
Derivative collateral	**311.9**
Intangibles	**222.3**
Total Leverage 'Other Assets'	**27,645.8**

1. Reflects gross off-balance sheet post application of CCF and CRM

5.8 Off-balance sheet exposure reconciliation

The table shows the reconciliation of the Off-balance sheet exposures to the leverage measure of exposure:

As at 30 June 2016	**Off balance sheet items under regulatory scope**	**Undrawn commitments post leverage CCF**
Undrawn credit facilities unconditionally cancellable @10%	**1,768.7**	**176.9**
Medium/low risk trade related off-balance sheet items @20%	**-**	**-**
Medium risk trade related off-balance sheet items @50%	**-**	**-**
Other off-balance sheet items @100%	**666.8**	**666.8**
Securities financing transactions	**920.1**	**-**

Derivatives: Futures	**6.8**	**-**
Total off-balance sheet items	**3,362.4**	**843.7**

5.9 Fully-loaded leverage ratio

	As at 30 June 2016	As at 31 December 2015
Derivative exposures	**424.2**	344.5
Securities financing transactions (SFTs)	**113.3**	86.1
Other Assets	**27,645.9**	28,980.3
Off-balance sheet items	**843.6**	938.6
Regulatory deductions and other adjustments	**(329.3)**	(212.2)
Total fully loaded leverage exposure	**28,697.7**	30,137.3
Fully loaded CRD IV Tier 1 Capital	**967.5**	1,151.1
Fully loaded leverage ratio	**3.4%**	3.8%

The fully-loaded leverage ratio is 3.4% as at 30 June 2016 (31 December 2015: 3.8%). The leverage ratio is calculated as Tier 1 capital divided by adjusted balance sheet exposures.

The Bank anticipates that its leverage ratio will sustainably meet 3.0% or greater by the end of the plan. However, it is expected to reduce in the intervening period.

INDEPENDENT REVIEW REPORT TO THE CO-OPERATIVE BANK PLC

Introduction

We have been engaged by the Company to review the set of the condensed consolidated set of financial statements in the Interim Financial Report for the six months ended 30 June 2016 which comprises the Bank income statement, the Bank statement of comprehensive income, the Bank balance sheet, the Bank statement of cash flows, the Bank statement of changes in equity and the related explanatory notes 1 to 16. We have read the other information contained in the Interim Financial Report and considered whether it contains any apparent misstatements or material inconsistencies with the information in the condensed consolidated set of financial statements.

This report is made solely to the Bank in accordance with guidance contained in International Standard on Review Engagements 2410 (UK and Ireland) "Review of Interim Financial Information Performed by the Independent Auditor of the Entity" issued by the Auditing Practices Board. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Bank, for our work, for this report, or for the conclusions we have formed.

Directors' Responsibilities

The Interim Financial Report is the responsibility of, and has been approved by, the Directors. The Directors are responsible for preparing the Interim Financial Report in accordance with the Disclosure and Transparency Rules of the United Kingdom's Financial Conduct Authority.

As disclosed in note 1, the annual financial statements of the Bank are prepared in accordance with IFRSs as adopted by the European Union. The condensed consolidated set of financial statements included in this half-yearly financial report has been prepared in accordance with International Accounting Standard 34, "Interim Financial Reporting", as adopted by the European Union.

Our Responsibility

Our responsibility is to express to the Bank a conclusion on the condensed consolidated set of financial statements in the Interim Financial Report based on our review.

Scope of Review

We conducted our review in accordance with International Standard on Review Engagements (UK and Ireland) 2410, "Review of Interim Financial Information Performed by the Independent Auditor of the Entity" issued by the Auditing Practices Board for use in the United Kingdom. A review of interim financial information consists of making enquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with International Standards on Auditing (UK and Ireland) and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

Conclusion

Based on our review, nothing has come to our attention that causes us to believe that the condensed consolidated set of financial statements in the Interim Financial Report for the six months ended 30 June 2016 is not prepared, in all material respects, in accordance with International Accounting Standard 34 as adopted by the European Union and the Disclosure and Transparency Rules of the United Kingdom's Financial Conduct Authority.

Emphasis of Matter – going concern

In forming our conclusion on the Interim Financial Report, which is unmodified, we have considered the adequacy of the disclosures made in note 1.3 to the Interim Financial Report concerning the Bank's ability to continue as a going concern. In that section, the directors set out the risks associated with the successful execution of the Bank's 2016-2020 Updated Plan. The matters explained in note 1.3 to the Interim Financial Report represent material uncertainties which may cast significant doubt upon the Bank's ability to continue as a going concern. The condensed consolidated set of financial statements does not include the adjustments that would result if the Bank was unable to continue as a going concern.

Ernst & Young LLP
London, United Kingdom
17 August 2016

THE BANK INCOME STATEMENT

For the period ended 30 June 2016

All amounts are stated in £m unless otherwise indicated

	Note	**Period to 30 June 2016**	Period to 30 June 2015
Interest receivable and similar income	4	**351.6**	415.7
Interest expense and similar charges	4	**(245.8)**	(253.8)
Net interest income		**105.8**	161.9
Fee and commission income		**44.3**	64.3
Fee and commission expense		**(24.2)**	(16.6)
Net fee and commission income		**20.1**	47.7
Income from investments		**0.2**	-
Other operating income/(expense)	5	**71.3**	(44.8)
Operating income		**197.4**	164.8
Operating expenses			
Operating expenses	6	**(360.5)**	(385.1)
Provision for customer redress		**(18.9)**	(28.5)
Total operating expenses		**(379.4)**	(413.6)
Operating losses before net impairment gains		**(182.0)**	(248.8)
Net impairment gains on loans and advances	9	**4.6**	44.6
Operating loss		**(177.4)**	(204.2)
Share of post-tax losses from joint ventures		**0.4**	-
Loss before taxation		**(177.0)**	(204.2)
Income tax	7	**44.9**	(28.9)
Loss for the financial period		**(132.1)**	(233.1)
Attributable to:			
Equity shareholders		**(132.1)**	(233.3)
Non-controlling interests		**-**	0.2
		(132.1)	(233.1)
Loss per share (basic and fully diluted)		**(29.26)p**	(51.67)p

Notes 1 to 16 form part of these financial statements.

THE BANK STATEMENT OF COMPREHENSIVE INCOME

For the period ended 30 June 2016

All amounts are stated in £m unless otherwise indicated

	Period from 1 January 2016 to 30 June 2016			Period from 1 January 2015 to 30 June 2015		
	Equity shareholders	**Non-controlling interests**	**Total**	Equity shareholders	Non-controlling interests	Total
(Loss)/profit for the period	**(132.1)**	**-**	**(132.1)**	(233.3)	0.2	(233.1)
Items that may be recycled to profit and loss:						
Changes in cash flow hedges						
Net changes in fair value recognised directly	**60.9**	**-**	**60.9**	(17.0)	-	(17.0)

in equity						
Income tax	**(17.8)**	**-**	**(17.8)**	1.8	-	1.8
Transfers from equity to income or expense	**7.5**	**-**	**7.5**	(6.4)	-	(6.4)
Income tax	**-**	**-**	**-**	0.6	-	0.6
Changes in available for sale assets						
Net changes in fair value recognised directly in equity	**83.7**	**-**	**83.7**	(12.3)	-	(12.3)
Income tax	**5.6**	**-**	**5.6**	4.9	-	4.9
Transfers from equity to income or expense	**(134.8)**	**-**	**(134.8)**	-	-	-
Income tax	**-**	**-**	**-**	-	-	-
Items that may not be recycled to profit and loss:						
Changes in defined benefit pension reserve						
Recognition of defined benefit plan	**81.7**	**-**	**81.7**	-	-	-
Income tax	**(21.2)**	**-**	**(21.2)**	-	-	-
Other comprehensive income/(expense) for the financial period, net of income tax	**65.6**	**-**	**65.6**	(28.4)	-	(28.4)
Total comprehensive (expense)/income for the financial period	**(66.5)**	**-**	**(66.5)**	(261.7)	0.2	(261.5)

Notes 1 to 16 form part of these financial statements.

THE BANK BALANCE SHEET
At 30 June 2016
All amounts are stated in £m unless otherwise indicated

	Note	**As at 30 June 2016**	As at 31 December 2015
Assets			
Cash and balances at central banks		**2,282.6**	2,678.5
Loans and advances to banks		**1,138.8**	871.0
Loans and advances to customers	9a	**19,595.4**	19,690.4
Fair value adjustments for hedged risk	9b	**179.4**	94.0
Investment securities – loans and receivables	10	**14.3**	15.0
Investment securities – available for sale	10	**3,653.4**	4,296.8
Investment securities – fair value through income or expense	10	**74.5**	582.4
Derivative financial instruments		**625.4**	370.1
Non-current assets classified as held for sale	8	**22.4**	3.4
Equity shares		**43.9**	55.6
Investments in joint ventures		**6.1**	4.9
Investment properties		**2.2**	2.1
Property, plant and equipment		**45.7**	46.1
Intangible assets		**140.6**	142.8
Other assets		**234.7**	124.1
Prepayments and accrued income		**54.5**	43.5
Deferred tax assets	7	**0.3**	7.6
Net retirement benefit asset	12	**81.7**	-
Total assets		**28,195.9**	29,028.3
Liabilities			
Deposits by banks		**877.3**	725.9
Customer accounts		**22,048.4**	22,732.0
Customer accounts – capital bonds		**37.0**	77.4
Debt securities in issue		**2,304.2**	2,554.3
Derivative financial instruments		**572.6**	346.9
Other borrowed funds		**490.3**	459.9
Other liabilities		**40.6**	68.8
Accruals and deferred income		**149.3**	152.5
Provisions for liabilities and charges	11	**348.1**	499.2

Current tax liabilities		**-**	0.3
Deferred tax liabilities	7	**31.3**	47.8
Total liabilities		**26,899.1**	27,665.0
Capital and reserves attributable to the Bank's equity holders			
Ordinary share capital		**22.6**	22.6
Share premium account		**1,736.9**	1,736.9
Retained earnings		**(1,028.5)**	(896.4)
Available for sale reserve		**10.1**	55.6
Capital redemption reserve		**410.0**	410.0
Cash flow hedging reserve		**85.2**	34.6
Defined benefit pension reserve		**60.5**	-
Total equity		**1,296.8**	1,363.3
Total liabilities and equity		**28,195.9**	29,028.3

Notes 1 to 16 form part of these financial statements.

THE BANK STATEMENT OF CASH FLOWS
For the period ended 30 June 2016
All amounts are stated in £m unless otherwise indicated

	Period to 30 June 2016	Re-presented Period to 30 June 2015
Cash flows (used in)/from operating activities:		
Loss before taxation	**(177.0)**	(204.2)
Adjustments for:		
Interest payable in respect of other borrowed funds	**22.6**	11.6
Impairment gains on loans and advances	**(4.6)**	(44.6)
Depreciation and amortisation	**16.7**	20.5
Impairment of intangible assets	**5.7**	-
Interest amortisation	**2.4**	(0.3)
Fair value and interest accrual movements on investment securities	**(105.8)**	21.7
Impairment of property, plant and equipment	**0.3**	-
Profit on disposal of property, plant, equipment and software	**(2.1)**	(0.2)
Loss on sale of loans and advances to customers	**4.4**	34.0
Unwind of fair value adjustments arising on transfer of engagements	**94.7**	66.4
	(142.7)	(95.1)
Increase in prepayments and accrued income	**(11.0)**	(4.5)
(Decrease)/increase in accruals and deferred income	**(3.2)**	17.5
Increase in deposits by banks	**151.4**	99.2
Decrease in customer accounts and capital bonds	**(724.0)**	(2,934.4)
Decrease in debt securities in issue	**(344.8)**	(592.7)
(Increase)/decrease in loans and advances to banks	**(365.3)**	495.2
Decrease in loans and advances to customers	**95.2**	2,999.8
Net movement of other assets and other liabilities	**(324.2)**	72.2
Net cash flows (used in)/from operating activities	**(1,668.6)**	57.2

Cash flows from/(used in) investing activities:		
Purchase of tangible and intangible fixed assets	**(27.0)**	(23.2)
Proceeds from sale of property, plant and equipment	**3.4**	22.1
Purchase of investment securities	**(161.2)**	(943.4)
Proceeds from the sale of equity shares	**41.8**	-
Proceeds from sale and maturity of investment securities	**1,340.8**	421.3
Net cash flows from/(used in) investing activities	**1,197.8**	(523.2)

Cash flows from/(used in) financing activities:		
Interest paid on other borrowed funds	**(22.6)**	(11.6)
Net cash flows from/(used in) financing activities	**22.6**	(11.6)

Decrease in cash and cash equivalents	**(493.4)**	(477.6)
Cash and cash equivalents at the beginning of the financial period	**3,139.7**	5,577.1
Cash and cash equivalents at the end of the financial period	**2,646.3**	5,099.5

Cash and balances with central banks	**2,239.7**	4,525.6
Held for sale	**-**	12.8
Loans and advances to banks	**406.6**	561.1
Cash and cash equivalents at the end of the financial period	**2,646.3**	5,099.5

The comparatives have been re-presented to more fairly reflect their nature.

Notes 1 to 16 form part of these financial statements.

THE BANK STATEMENT OF CHANGES IN EQUITY
For the period ended 30 June 2016
All amounts are stated in £m unless otherwise indicated

	Attributable to equity holders of the Bank									
	Share capital	**Share premium**	**Available for sale reserve**	**Cash flow hedging reserve**	**Capital redemption reserve**	**Defined benefit pension reserve**	**Retained earnings**	**Total**	**Non-controlling interest**	**Total equity**
Period from 1 January 2016 to 30 June 2016										
Balance at the beginning of the period	**22.6**	**1,736.9**	**55.6**	**34.6**	**410.0**	**-**	**(896.4)**	**1,363.3**	**-**	**1,363.3**
Total comprehensive (expense)/income for the period	**-**	**-**	**(45.5)**	**50.6**	**-**	**60.5**	**(132.1)**	**(66.5)**	**-**	**(66.5)**
Balance at the end of the period	**22.6**	**1,736.9**	**10.1**	**85.2**	**410.0**	**60.5**	**(1,028.5)**	**1,296.8**	**-**	**1,296.8**

	Attributable to equity holders of the Bank									
	Share capital	Share premium	Available for sale reserve	Cash flow hedging reserve	Capital redemption reserve	Defined benefit pension reserve	Retained earnings	Total	Non-controlling interest	Total equity
Period from 1 January 2015 to 30 June 2015										
Balance at the beginning of the period	22.6	1,736.9	24.6	59.0	410.0	-	(273.1)	1,980.0	34.5	2,014.5
Total comprehensive (expense)/income for the period	-	-	(7.4)	(21.0)	-	-	(233.3)	(261.7)	0.2	(261.5)
Balance at the end of the period	22.6	1,736.9	17.2	38.0	410.0	-	(506.4)	1,718.3	34.7	1,753.0

Notes 1 to 16 form part of these financial statements.

NOTES TO THE BANK INTERIM FINANCIAL STATEMENTS
For the period ended 30 June 2016
All amounts are stated in £m unless otherwise indicated.

1.Basis of preparation and significant accounting policies

1.1 Basis of preparation

This consolidated Interim Financial Report for the half year ended 30 June 2016 has been prepared in accordance with the Disclosure and Transparency Rules of the Financial Conduct Authority and with IAS 34 'Interim Financial Reporting', as adopted by the European Union. The Interim Financial Report should be read in conjunction with the Bank's 2015 Annual Report and Accounts, which have been prepared in accordance with IFRS as adopted by the European Union.

The information contained within this report for the half year 30 June 2016 does not constitute statutory accounts as defined by Section 434 of the Companies Act 2006. A copy of the statutory accounts for that year has been delivered to the Registrar of Companies. The auditor's report on those accounts was unqualified, and did not contain a statement under section 498(2) or (3) of the Companies Act 2006, but did make reference to an emphasis of matter in relation to going concern (see note 1.3 for further detail).

The Interim Financial Report 2016 was approved by the Board of Directors on 17 August 2016.

1.2 Significant accounting policies
The same accounting policies and presentation are followed in the Interim Financial Report 2016 as applied in the 2015 Annual Report and Accounts. Significant additions and changes to underlying methodologies are discussed within the critical judgements and estimates section. Information on pronouncements that will be relevant to the Bank in future periods is provided in the 2015 Annual Report and Accounts.

The Bank's implementation of IFRS 9 financial instruments (IFRS 9) continues with focus on model development and finalisation of certain judgement areas. As the Bank has not yet fully developed and tested its models, it is not yet possible to reliably estimate the impact of IFRS 9.

1.3 Going concern

Introduction
In line with provision C1.3 of the 2014 UK Corporate Governance Code, the Directors consider it appropriate to adopt the going concern basis of preparing the financial statements but note that material uncertainties exist and thus have looked to identify and disclose those material uncertainties and any other necessary disclosures to give a true and fair view. The Directors have a reasonable expectation that the Bank will continue to have the necessary resources to continue in business for the foreseeable future, taking into account the matters referred to below.

When considering the going concern status of the Bank, the Directors have referenced appendix A of the Financial Reporting Council's Guidance on Risk Management, Internal Control and Related Financial and Business Reporting published in September 2014, which explicitly covers the going concern basis of accounting and material uncertainties.

The assessment of the appropriateness of the going concern basis of accounting for the Bank's 2016 Interim report has been subject to a thorough process involving analysis and discussion by management, Executive and Board Committees and the Board, in line with our governance process and discussions with the Bank's Regulators. This analysis included a particular focus on the 12 month period following the date of publication of the financial statements.

The Directors have assessed the going concern status using a framework focusing on the Bank's capital, liquidity, profitability, continued regulatory forbearance and other material issues. Following the EU referendum result the Bank has refreshed the macroeconomic assumptions upon which its 2016-2020 Strategic Plan (the Bank's Updated Plan) were based; this includes a reduction in the Bank of England Base rate to 0.25%. Management and the Board have reviewed the latest forecast covering the entire planning horizon in order to make the going concern assessment. This has also been discussed with the PRA.

The PRA has noted that the Board's assessment includes a number of uncertainties that continue to exist within the Updated Plan, including the impacts of the result of the EU referendum on the UK economic outlook, which are likely to affect the Bank's ability to perform in line with the Updated Plan.

The Updated Plan
The Updated Plan continues to focus on the creation of a simpler and more efficient Core Bank serving UK retail and SME customers. Following certain headwinds however the Updated Plan no longer includes the active deleverage of the Optimum portfolio. Instead the Bank is continuing to review the possibility of future disposals of the Optimum portfolio in light of further changes in economic conditions and forecasts, and to ensure the desired balance between risk and reward is maintained.

EU referendum result
The result of the EU referendum creates uncertainty both in terms of economic and political outcomes. The overarching strategy remains as per the Updated Plan and although the Bank expects to remain capital generative in the longer term it is possible that these risks may lower the levels of future capital generation.

As with all UK retail focused banks, the ability to improve net interest margin is significantly reduced in a persistently low, or falling base rate environment, the likelihood of which increased following the EU referendum. This directly impacts the Bank's ability to generate sustainable profits in the quantum previously anticipated and could impact the Bank's ability to deliver the required reductions in its cost:income ratio. Similarly weaker outlooks for a number of other macroeconomic variables, including unemployment, house prices and commercial real estate prices are likely to adversely impact the Bank's capital requirements compared to those expected within the Updated Plan.

It is expected that the Bank will meet ICG by the end of the planning horizon, but with less headroom against the expectation within the Updated Plan. Given the recent announcement from the Bank of England regarding the relaxation of the PRA buffer and the uncertainty about how this measure will now evolve over the planning horizon, the Bank cannot conclude on whether its expected ICG surplus at the end of the planning horizon would be sufficient to result in a surplus position to the in force PRA buffer at that time.

Capital
Total CRD IV capital resources as at 30 June 2016 are £1.4bn (31 December 2015: £1.6bn) with Core Tier 1 capital after regulatory deductions of £1.0bn (31 December 2015: £1.2bn). The Bank's CET1 ratio stands at 13.4% (31 December 2015: 15.5%) on a CRD IV end point basis, representing significant headroom above the regulatory minimum

As at 30 June 2016, the Bank did not meet the ICG for total capital set by the PRA, a position anticipated within the Bank's Updated Plan, accepted by the PRA. This position is expected to continue against the in force ICG requirements for most of the duration of the 2016-2020 planning period.

The Bank is mindful of the capital implications of the Bank of England's minimum requirement for own funds and eligible liabilities (MREL) regime and the increased debt issuance this will drive, for the banking industry in general but also for the Bank.

The Bank's Updated Plan incorporates MREL qualifying issuance commencing in 2018 which is the Board's current view of the earliest time when such issuance may be feasible. The PRA and the Bank of England have indicated their strong preference that the Bank incorporates an earlier profile of MREL issuance than currently contemplated by the Bank's Updated Plan. For further detail regarding MREL please refer to the Principal Risks and Uncertainties section.

The Bank must also seek to reduce those risks that sit outside of the Pillar 1 requirements under the ICG framework, for example, through seeking to reduce any Pillar 2a capital requirements with regards to operational risk.

The Bank continues to monitor the regulatory capital horizon for any new pieces of regulation that could impact the Bank's ability to deliver the Updated Plan. This includes, but is not limited to, any updates with regards to the implementation of the leverage ratio and MREL targets for the UK Banking sector.

The Bank is currently not compliant with CRR provisions related to the use of an Internal Ratings Based (IRB) approach to modelling its credit risk capital requirements. A review by the PRA took place during 2015 and identified areas of non-compliance and inadequate procedures relating to use of an IRB approach requiring improvement and a remediation plan to rectify under supervisory guidance. These areas include the redesign of model risk policy and model inventory and the strengthening of the overall control environment. In March 2016 the Bank received a formal communication from the PRA regarding the levying of an additional Pillar 2a add on to cover the risks outlined above which has been factored into the Updated Plan.

The Bank is progressing a remediation plan in order to address the areas of non-compliance and has planned that this additional Pillar 2a add-on will be removed by the end of 2017, however this is subject to PRA approval.

A failure to address model risk non-compliance would potentially result in regulatory action such that the Bank's permission to use an IRB approach could be removed by the PRA, resulting in (among other things) the use of a standardised approach to modelling credit risk. This could expose the Bank to a material increase in its calculated RWAs with a consequent requirement to hold additional capital, the creation of an additional ICG deficit and a reduction in the Bank's CET1 ratio.

Any materialisation of proposals to implement floors for PD, LGD and CCF in Retail mortgages could also impact the planned allocation of capital to such assets through the life of the Plan.

The Bank remains reliant on the continued support of the PRA regarding its present inability to meet regulatory capital requirements, including CRR, ICG and PRA buffer compliance.

Liquidity
The Bank's liquid asset ratio at 30 June 2016 was 12.7% (31 December 2015: 15.6%).

As at 30 June 2015 the Bank had a significant surplus stock of high quality liquid assets to its regulatory Pillar 1 LCR and regulatory add-ons and a surplus to its internal liquidity risk appetite.

During the period to 30 June 2016, customer liabilities have fallen by £0.7bn which has in turn reduced the level of liquid assets the Bank held. The Bank continues to proactively manage its deposits down from historically high levels, to match the funding requirements of the Core and Non-core businesses. Period on period there has been a reduction in the deleverage activity within the Non-core Bank and an increase in Core Bank customer assets which has resulted in a level of high quality liquid asset holdings closer to that of the rest of the industry and closer to the Bank's own liquidity risk appetite.

The Bank has replaced the majority of wholesale funding that matured in the first half of this year.

The Bank expects to manage its liquidity such that it will stay above the current and future LCR regulatory minima across the planning period.

Regulatory matters
Since early 2014 the Bank has run major programmes of IT remediation, including the migration of IT Infrastructure to an IBM managed service platform. Collectively these programmes are expected, in time, to address a range of deficiencies in the Bank's IT estate including, notably, the inability to prove disaster recovery capability for all critical business processes. In Q1 2015 the Bank received written confirmation from the FCA that the lack of proven end to end disaster recovery capability constituted a breach of the FCA's Threshold Conditions.

Via the remediation programmes outlined above, the Bank has set out to build resilience into each component of its critical IT infrastructure, aiming to prove the Bank's ability to recover its critical services in the event of the failure of any individual component. By Q2 2016 the Bank believes that all of the relevant components had been addressed.

The Bank expects that this component-level proof of recoverability, taken in aggregate, delivers a reasonable level of recoverability from a major IT infrastructure failure, e.g. the loss of a data centre. The Bank is awaiting the outcome of a review by the FCA of the Bank's compliance with respect to IT related Threshold Conditions

Risks and uncertainties
The key risks and uncertainties associated with the successful execution of the strategies within the Bank's Updated Plan include, but are not limited to:

1. the Regulators' continued acceptance of the Bank's inability to meet regulatory requirements including CRR, ICG, PRA buffer compliance and other Threshold Conditions, which have been further impacted by the macroeconomic uncertainty as a result of the UK referendum vote to exit the EU. To the extent this acceptance is withdrawn, there is further deterioration in the Bank's expected future performance from the Updated Plan, or regulatory capital requirements are increased for any reason, then additional CET1 or other capital may be required over and above that included in the Updated Plan in order for the Bank to remain a going concern, and the PRA or FCA could exercise their powers under the Banking Act of 2009;

2. if in due course the Bank becomes subject to a binding requirement to issue MREL and it is unable to do so when required, the Bank of England and the PRA can agree to accept the Bank's original issuance plan, a revised issuance plan, use their respective powers to require some other remediating action on the part of the Bank or in the absence of any of these the Bank of England may exercise its powers under the Banking Act 2009. In considering going concern the Board has taken note of the contents of PRA consultation paper (CP 44/15) and the Board believes that resolution is less likely than the other outcomes while the Bank is executing the Updated Plan as accepted by the PRA and continuing to de-risk the Bank;

3. the Bank's IT systems have been under-invested in for a considerable period of time. The Bank needs to urgently and significantly improve and re-engineer its existing IT platform as the existing infrastructure is unsuitable and inherently fragile. The migration of IT Infrastructure to an IBM platform will further improve the Bank's ability to test and demonstrate this recoverability of service. The required improvement and re-engineering of the Bank's IT platform and operational process is necessary and significant in scale, complexity and cost. In common with any programme of this scale it carries a significant level of execution risk. Any delays in, or failure by, the Bank to deliver the re-engineering of the Bank's IT platform may result in ongoing risk of technology failure, significant additional investment costs, inability to deliver operating cost reductions or revenue generating capability. This would subject the Bank to further regulatory scrutiny or sanction, and impact the Bank's ability to deliver its strategy. The Bank's Regulators are fully aware of the steps the Bank is taking to address these operational risks;

4. large scale outsourcings and transformation projects may be subject to significant risk of delay to completion, increased costs and operational disruption in the short term. Moreover, the Bank must ensure it has appropriate governance and processes to manage the relationship with outsourcing partners. The Bank has entered into an outsourcing contract with Capita for the provision of mortgage origination and servicing processing. Capita has taken over and is currently operating the Bank's existing mortgage processing and this is operating satisfactorily using the Bank's existing infrastructure. Work is underway on the design and build of new Capita systems to deliver enhancements in mortgage origination and processing. New lending processing is intended, in time, to be undertaken on the new Capita systems to be followed by a phased migration of existing business. The intention is to deliver long term cost efficiencies and an improved customer experience. This is now likely to be significantly delayed. Notwithstanding potential mitigation, there remains material uncertainty over the extent and implications of the delay in the transformation elements of the outsourcing contract with Capita. This could result in any of the following: increased costs; reduction in the transformation scope; and increased legal risk for the Bank. Consequently there is a risk of an adverse effect on the Bank's mortgage business and its Updated Plan;

5. the Bank participates in The Co-operative Group's defined benefit pension scheme (Pace). As long as the Bank remains a participating employer in Pace, the Bank could be 'last man standing' in the event of the failure of one or more of the other participating employers meaning that some or all of Pace's liabilities would need to be borne by the Bank. In addition, a material difference to current estimates of the funding of the pension scheme, or the Bank being forced to pay for a greater proportion than currently envisaged, could increase the Bank's Pillar 2a Capital requirements or cause additional expense through increased contributions; and

6. more generally, the further materialisation of particular challenges that are described in the Principal Risks and Uncertainties section and include, but are not limited to: ability to achieve the targeted cost savings; ability to retain customers and deposits; the timing and quantum of impacts to capital from the asset reduction exercise within the Corporate CoAM business; meeting its forecast improvements in net interest margin; the ability of the Bank to generate sufficient Core Bank asset growth; a possible further deterioration in the quality of the Bank's asset portfolio; ability to deliver the complex transformation plan affecting the operations and systems without significant delay and within budget, failure to achieve either of which could have negative impacts on the Bank's financial performance; adverse macroeconomic or political outcomes negotiated as part of the UK leaving the EU; unplanned or increased costs from, for example, existing or future (including any not yet known or fully assessed) conduct risk matters, regulatory investigations, unforeseen regulatory change, IT investment and the ability to maintain the Bank's access at, an appropriate cost, to liquidity and funding including any current or future central bank initiatives.

Conclusion
After making enquiries of management and considering the Bank's latest forecasts across the Bank's planning horizon covering the Bank's income statement, balance sheet, capital and liquidity projections, in particular those for the 12 month period following the date of issuance of the Bank's financial statements, the Directors have concluded that the macroecomic risks which have materialised in H1 2016 and those further risks outlined above represent material uncertainties, which may cast significant doubt upon the Bank's ability to continue as a going concern. In the event one or more of these material uncertainties were to materialise the Bank may be unable to continue realising its assets and discharging its liabilities in the normal course of business. As noted, the Bank remains reliant on the continued support of the PRA regarding its

inability to meet CRR, including ICG and PRA buffer compliance, during and beyond the period of the going concern assessment.

The PRA have confirmed they continue to accept the Bank's Updated Plan with reference to the latest forecast, and this combined with the stable liquidity position of the Bank and subject to the material risk and uncertainties outlined above, allow the Directors to conclude that they have a reasonable expectation that the Bank will have adequate resources to continue in business for at least the next 12 months. Consequently the Bank has adopted the going concern basis in preparing these financial statements. This set of financial statements does not include the adjustments that would result if the Bank was unable to continue as a going concern.

2. Critical judgements and estimates

The preparation of financial information requires management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

Estimates and assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised and in any future periods affected.

The judgements and assumptions that are considered to be the most important to the portrayal of the Bank's financial condition for the period ended 30 June 2016 are those relating to loan impairment provisions, conduct risk provisions, deferred tax, pensions, separation provision, effective interest rates (EIR) and fair value adjustments and group relief receivable.

a. Loan impairment provisions

i. Overview

The loan portfolios are reviewed on a regular basis to assess for impairment. In determining whether an impairment provision should be recorded, judgements are made as to whether there is objective evidence that a financial asset or portfolio of financial assets is impaired as a result of loss events that occurred after recognition of the asset and by the balance sheet date.

The calculation of impairment loss includes expectations of levels of future cash flow and is based on both the likelihood of a loan or advance being written off and the estimated loss on such a write off.

The changes in impairment provisions for all books of business result from management review of assumptions with respect to the determination and operational alignment of: the probability of the possession of collateral given default (PPD); treatment of forbearance; length of loss emergence periods; timing of impairment recognition, and the formalising of charge off policy. Further explanation of the treatment of forborne balances is included in the Bank's risk management disclosures.

The methodology for loan impairment for both Core (unsecured and secured residential) and Non-core (Corporate and Optimum) segments is explained on pages 180 to 182 in the Annual Report and Accounts for the year ended 31 December 2015. During the first half of the year, enhancements to the interest only methodology, affecting Core Secured and Optimum portfolios, have been made to incorporate customer repayment vehicle data and more appropriate forced sale discount (FSD) and PPD parameters.

The impact of the recent macroeconomic event (EU referendum) on impairment adequacy has been assessed and as per IAS 39 guidance, no additional impairment has been raised at this time, however close tracking of impairment will continue on a monthly basis through the existing governance process. Stress analysis has been performed on the collective impairments to understand potential sensitivity to adverse movements.

ii. Collective provisions

Loans which have not been assessed individually for impairment are assessed for collective impairment. Collective provisions cover losses which have been incurred but not yet identified on loans subject to individual assessment and for homogeneous groups of loans that are not considered individually significant. Typically, retail lending portfolios are assessed for impairment on a collective basis as the portfolios generally consist of large pools of homogenous loans.

a) Core

i) Unsecured and secured residential

The Bank's collective provision for unsecured and secured retail personal advances is £99.5m (31 December 2015: £101.5m).

A key estimate within the unsecured models is the probability that impaired accounts move to a default status during the outcome period. The model uses historical actual data over a defined period of time to arrive at an average probability of accounts moving to default. If the maximum probability of default (PD) had been used for each category of arrears and for each product, this would increase the collective provision by £3.4m for all of the unsecured portfolios.

A key estimate of the secured impairment model provisioning is forced sales discount. The forced sales discount is an average and is calculated using historical actual data over a defined outcome period. If the maximum forced sales discount for the outcome period was used to calculate the provision across the secured portfolios excluding Optimum it would increase by £0.6m.

A key estimate is the collateral value. A 10% decrease to the indexed collateral used in the model would increase the provision by £1.6m.

ii) BaCB
The Bank's collective provision against corporate loans in the Core division has increased to £1.4m (31 December 2015: £0.8m). A key estimate is default rates. The impact of increasing the default rates by 10% is an increase in the collective provision of £0.1m. The impact of decreasing by 10% the probability of resolution for defaulted customers is an increase in the collective provision of £0.1m.

b) Non-core

i) Corporate CoAM
The Bank's collective provision against Corporate CoAM loans in the Non-core division has decreased to £0.8m (31 December 2015: £7.5m). A key estimate is default rates. The impact of increasing the default rates by 10% is an increase in the collective provision of £0.1m. The impact of decreasing by 10% the probability of resolution for defaulted customers is an increase in the collective provision of £0.5m. The impact of increasing other parameters that affect the loss rate by 10% is not significant.

ii) Optimum collective
In addition to the above, collective provisions of £14.2m (31 December 2015: £3.3m) are held in the Optimum segment of the Non-core business.

A key estimate of the secured impairment model provisioning is forced sales discount. The forced sales discount is an average and is calculated using historical actual data over a defined outcome period. If the maximum forced sales discount for the outcome period was used to calculate the provision it would increase by £1.9m.

A key estimate is the collateral value. A 10% decrease to the indexed collateral used in the model would increase the provision by £7.6m.

iii) Individual provisions
Individual provisions are recorded for loans which are assessed for impairment on an individual basis. Loans considered as individually significant are typically Corporate CoAM loans.

a) Core

BaCB
The Bank's individual impairment provision on BaCB loans totals £0.5m (31 December 2015: £1.0m).

b) Non-core

Corporate CoAM
The Bank's individual impairment provision on Corporate CoAM loans totals £83.2m (31 December 2015: £118.4m). The provision has decreased reflecting the Bank's strategic deleveraging of Non-core assets.

For further information on credit risk and impairment, see the Bank's risk management disclosures.

b. Conduct risk provisions

i. Overview
The Bank has identified a number of conduct risk and legal issues against which it has raised provisions, based on management's best estimate of the total potential costs to the Bank.

The calculation of these conduct and legal provisions requires significant judgement by management in determining appropriate assumptions. Key assumptions include basis of redress, operating costs of resolving redress, legal analysis, the level of complaints, Bank uphold rates, proactive contact and response rates and the FOS referral and uphold rates. This is discussed in more detail in the 2015 Annual Report and Accounts.

ii. Payment Protection Insurance (PPI)
A provision of £101.9m (31 December 2015: £87.0m) has been recorded in respect of potential customer redress relating to past sales of PPI. The provision is in respect of the total expected cost of carrying out this work and paying compensation, making total provisions raised to date of £457.3m (31 December 2015: £423.8m).

Overall complaint redress performance in the half year to 30 June 2016 has been in line with expectations. The £33.5m increase has been recognised to reflect the Bank's initial estimates of the impact of the FCA Consultation Paper CP 16/20.

The key assumptions within the calculation of the current provision are complaint volumes, uphold rates, administration costs and average redress.

The current position, expected movement in position and baseline sensitivities of the key estimates are outlined below:

Description of estimate	Current position	Future expected	Sensitivity on current position
Number of inbound valid[1] complaints	97k	26k	1,000 = £2.6m

Proactive Mailings	45k	0k	1,000 = £1.7m
Response rate to proactive mailings	61%	61%	1% = £1.3m
Average uphold rate per valid[1] complaint	63%	74%	1% = £0.7m
Average redress per upheld complaint[2,3]	£3,448	£2,812	£100 = £1.8m

1. Valid complaints excludes those complaints for which no PPI policy exists
2. Average redress per upheld complaint included all complaints either inbound or in response to proactive mailings that were offered excluding Plevin
3. Average Redress per Upheld Complaint excludes Plevin redress

The Bank has assumed that the FCA time bar comes into force on 30 June 2019 as proposed in CP16/20. Based on our current assumptions each month's delay would cost £1.9m to cover customer redress and delivery costs.

These assumptions remain subjective, in particular due to the uncertainty associated with future claims levels. The resulting provision represents the best estimate of all future expected costs of PPI redress, however, it is possible the eventual outcome may differ from the current estimate and if this were to be material an adjustment to the provision will be made.

iii. Breaches of the technical requirements of the Consumer Credit Act (legal provision)
An amount of £32.7m (31 December 2015: £124.8m) has been provided regarding interest refunds following identification of breaches of the technical requirements of the CCA. The Bank's redress and remediation programme is ongoing but is expected to be completed in 2016. Once the Bank remediates open loan accounts they become compliant with the CCA and the Bank can start to recognise loan interest again.

The reduction in the gross provision reflects the 95% completion of the CCA redress programme and a more detailed analysis of the provision requirements for the residual account population The provision covers all interest accrued during non-compliance to the end of June 2016.

Included within the CCA provision are operating costs of £8.7m based upon the latest view of delivery timeframes.

iv. Other conduct/compliance related provisions
Other conduct/compliance related provisions include the following:

- £3.2m (31 December 2015: £5.9m) for potential customer redress relating to the processing of first payments on certain mortgages;
- £14.5m (31 December 2015: £27.3m) relating to potential customer redress in relation to mortgage early redemption charges;
- £0.9m (31 December 2015: £4.7m) for alleged failings in the introduction of third party sales of card and identification protection products (as part of an industry wide review announced by the FCA on 27 January 2015);
- £5.4m (31 December 2015: £6.5m) relating to potential customer redress due to mortgage customer detriment;
- £6.3m (31 December 2015: £9.4m) for potential customer redress in relation to arrears fees and charges;
- £22.8m (31 December 2015: £27.9m) relating to packaged accounts;
- £13.7m (31 December 2015: £15.0m) relating to provision for potential conduct issues incurred but not identified;
- £0.3m (31 December 2015: £1.2m) relating to potential customer redress and other costs in relation to mortgage documentation;
- £7.3m (31 December 2015: £21.9m) relating to cost of mortgage redress;
- £2.5m (31 December 2015: £3.6m) relating to interest rate swaps; and
- £17.9m (31 December 2015: £20.3m) of other conduct and legal provisions.

Key assumptions include basis of redress, operating costs of resolving redress, level of complaints, uphold rates, proactive contact and response rates and Financial Ombudsman Service referral and uphold rates.

c. Deferred tax
The Bank has recognised a deferred tax asset of £0.3m (31 December 2015: £7.6m) and a deferred tax liability of £31.3m (31 December 2015: £47.8m).

For further information on the accounting treatment of deferred tax and future rates of corporation tax can be found on page 183 in the Annual Report and Accounts for the year ended 31 December 2015.

d. Pensions

i. Defined contribution accounting for the Pace scheme

The Bank participates in Pace, a hybrid pension scheme consisting of a closed defined benefit section and a defined contribution section. There is currently insufficient information available to consistently and reliably identify the Bank's share of its liabilities in respect of this multi-employer scheme. For this reason defined benefit accounting is not possible and pension costs in respect of Pace are accounted for on a defined contribution basis in accordance with IAS 19 Employee Benefits (revised 2011). Pension costs are recognised as an expense in the Bank's income statement.

£nil (31 December 2015: £2.5m) has been recognised as a liability in relation to the annual deficit funding, as no obligation existed at the balance sheet date. A further agreement on deficit funding may be reached as the negotiations on Pace separation continue, and in the context of the 5 April 2016 triennial valuation which is due to be completed in July 2017. See note 12 for further details.

ii. Defined benefit accounting for the Britannia scheme

The Bank also participates in the Britannia Pension Scheme, which is a closed defined benefit scheme. Following consultation with the Trustee and legal advisors, changes were effected to the scheme whereby the Bank is now deemed to have a right to a refund of any surplus in the scheme, and as such has recognised the full IAS 19 surplus on its balance sheet as at 30 June 2016, in line with IFRIC 14.

No provision has been recognised in relation to the deficit funding as a) no deficit recovery plan has yet been agreed with the scheme Trustee, and b) the Bank is not required to recognise an onerous liability for irrecoverable minimum funding requirements under IFRIC 14. A formal agreement on deficit funding is expected to be reached following the finalisation of the 2014 triennial valuation, though this has not been finalised as of 30 June 2016. See note 12 for further details.

Further information on the background and financial implications of accounting for both the Pace and Britannia schemes can be found on pages 183 to 184 in the Annual Report and Accounts for the year ended 31 December 2015.

e. Separation provision

A provision of £33.6m (31 December 2015: £64.3m) is held against separation costs directly relating to the Bank's obligation to separate from The Co-operative Group.

A reasonably possible change in overall estimates of costs for key separation provision judgements, relating to both the rates paid for resources and time taken to complete the programme, could increase the provision by £8.0m.

Further detail can be found on page 184 of the Annual Report and Accounts for the year ended 31 December 2015.

f. Effective Interest Rate and Fair Value adjustments

The Bank accounts for mortgage balances on an EIR basis. The methodology for calculating the EIR adjustment is explained on page 184 in the Annual Report and Accounts for the year ended 31 December 2015. There has been no material change in the methodology during the first half of the year.

As a measure of the sensitivity a 0.5% increase in the assumed standard variable rate in place after the expiry of the fixed rate period for all products would result in an £8.1m (25.7%) increase in the EIR adjustment required to the loans and advances to customers balance as at 30 June 2016.

On the merger of the Bank and Britannia Building Society in August 2009, an exercise was undertaken to fair value the respective assets and liabilities of Britannia Building Society. These fair value adjustments are unwound on an EIR basis over the effective lives of the assets and liabilities. The methodology to unwind the fair value adjustments is explained on page 184 in the Annual Report and Accounts for the year ended 31 December 2015. There has been no material change in the methodology during the first half of the year.

The most significant fair value adjustment is that made to the Leek debt securities, which were valued below par upon merger. This adjustment has been unwinding towards the assumed call date of the underlying Leek debt securities. As a measure of the sensitivity of the remaining lives on these instruments, if the Leek notes were to be redeemed one month earlier than the assumed call date, the Leek notes fair value adjustment would decrease by £14.4m (10.1%) as at 30 June 2016, resulting in additional expense of £14.4m in the period to 30 June 2016.

g. Group relief receivable

As part of the negotiations relating to the separation of the Bank from The Co-operative Group, the Bank and The Co-operative Group agreed terms relating to the surrender of group relief between the entities in the Bank's tax group and entities in The Co-operative Group tax group. A deed sets out the basis of the agreement by The Co-operative Group to take proactive steps to allow it to maximise its claim for tax losses from the Bank for the accounting periods to 31 December 2012 and 31 December 2013. The deed also addresses the terms of the payment by The Co-operative Group to the Bank for those tax losses. The Interim 2016 condensed consolidated financial statements, which include a group relief receivable of £61.9m (31 December 2015: £60.1m), have been prepared on a basis consistent with the deed.

The Bank receives payment from The Co-operative Group when The Co-operative Group realises the benefit of the losses surrendered and at the corporation tax rate at which the benefit is realised. The value of the asset is sensitive to a number of assumptions including the forecast repayments provided by The Co-operative Group for the periods to 2018; The Co-operative Group's capital expenditure qualifying for capital allowances in future periods; The Co-operative Group's taxable profits in future periods; the Bank's extrapolation of the forecast repayments for the periods after 2018; the rate of corporation tax; the rates at which capital allowances on qualifying capital expenditure are available; and The Co-operative Group's capacity to claim the tax losses. If The Co-operative Group's capacity to realise benefit in 2018 from the previously surrendered losses decreases by 5%, the value of the group relief receivable decreases by £4.1m.

3. Segmental information

The Bank is managed as two divisions, Core and Non-core. Core represents activity consistent with the strategy and risk appetite of the Bank. This includes Retail, Business and Commercial Banking (BaCB), Treasury and other segments. Non-core business lines include activities not aligned with the current strategy of the Bank which are targeted for run down or exit.

Revenues are attributed to the segment in which they are generated. Transactions between the reportable segments are on normal commercial terms and internal charges and transfer pricing adjustments have been reflected in each segment.

Further detail of the components of the Core and Non-core divisions are provided in the Detailed Financial Review.

	Core					Non-core			
	Retail	**BaCB**	**Treasury**	**Other[1]**	**Total Core**	**Corporate CoAM**	**Optimum**	**Total Non-core**	**Total**
Period to 30 June 2016									
Net interest income/(expense)	**171.1**	**26.4**	**5.5**	**7.5**	**210.5**	**0.6**	**(9.6)**	**(9.0)**	**201.5**
Gains/(losses) on asset sales	**-**	**-**	**0.5**	**-**	**0.5**	**(12.1)**	**-**	**(12.1)**	**(11.6)**
Non-interest income/(expense)	**14.1**	**6.7**	**13.8**	**6.9**	**41.5**	**(4.7)**	**1.5**	**(3.2)**	**38.3**
Operating income	**185.2**	**33.1**	**19.8**	**14.4**	**252.5**	**(16.2)**	**(8.1)**	**(24.3)**	**228.2**
Direct costs	**(54.8)**	**(4.2)**	**(2.9)**	**-**	**(61.9)**	**(4.2)**	**(0.4)**	**(4.6)**	**(66.5)**
Impairment gains/(losses) on loans and advances	**3.3**	**(0.6)**	**-**	**(0.2)**	**2.5**	**15.1**	**(6.0)**	**9.1**	**11.6**
Contribution result	**133.7**	**28.3**	**16.9**	**14.2**	**193.1**	**(5.3)**	**(14.5)**	**(19.8)**	**173.3**
Operations and central costs									**(156.3)**
Operating project costs									**(19.7)**
Operating result									**(2.7)**
Remediation projects									**(71.3)**
Transformational projects									**(34.7)**
Severance									**(8.5)**
Gain on sale of equity shares									**58.1**
Share of post-tax profits from joint ventures									**0.4**
Conduct/legal risk									**(21.1)**
Fair value amortisation									**(97.2)**
Loss before taxation									**(177.0)**
Income tax									**44.9**
Loss for the period									**(132.1)**

1. Core Other no longer includes Unity Trust Bank (UTB). Following the sale agreement to dispose of the majority of its shareholding on 14 December 2015, the Bank was no longer deemed to control UTB and therefore no longer consolidates this into the Bank result.

The Board relies primarily on net interest income to assess the performance of each segment. As a result interest income is reported on a net basis to the Board. The Bank's activities are primarily in the UK.

	Core					Non-core			
	Retail	BaCB	Treasury	Other[1]	Total Core	Corporate CoAM	Optimum	Total Non-core	Total
Re-presented period to 30 June 2015									
Net interest income/(expense)	194.3	20.3	10.3	6.4	231.3	(6.3)	8.6	2.3	233.6
Losses on asset sales	-	-	(0.1)	-	(0.1)	(35.3)	(2.8)	(38.1)	(38.2)
Non-interest income/(expense)	28.2	5.6	0.5	(3.8)	30.5	8.2	2.4	10.6	41.1
Operating income	222.5	25.9	10.7	2.6	261.7	(33.4)	8.2	(25.2)	236.5
Direct costs	(60.8)	(5.1)	(3.9)	(5.3)	(75.1)	(5.3)	(0.4)	(5.7)	(80.8)
Impairment (losses)/gains on loans and advances	(4.8)	1.0	-	1.1	(2.7)	44.7	2.6	47.3	44.6
Contribution result	156.9	21.8	6.8	(1.6)	183.9	6.0	10.4	16.4	200.3
Operations and central costs									(182.1)
Operating project costs									(28.0)
Operating result									(9.8)
Remediation projects									(45.4)
Transformational projects									(39.3)
Severance									(6.4)

Gain on sale of equity shares	-
Share of post-tax profits from joint ventures	-
Conduct/legal risk	(49.0)
Fair value amortisation	(54.3)
Loss before taxation	(204.2)
Income tax	(28.9)
Loss for the period	(233.1)

1. Included within 'Core - Other' is Unity Trust Bank (UTB). UTB operates in the corporate banking and social economy sectors on behalf of trade unions and was consolidated into the Bank's results in the period to 30 June 2015 on the basis of control.

The 2015 comparatives have been re-presented as described in the Detailed Financial Review.

Reconciliation to statutory income statement	**Period to 30 June 2016**	Re-presented Period to 30 June 2015
Net interest income		
Total interest margin for reportable segments	**201.5**	233.6
Interest fair value unwind	**(93.8)**	(51.6)
Provision for conduct risk	**(1.8)**	(20.0)
Other	**(0.1)**	(0.1)
Net interest income	**105.8**	161.9
Non-interest income		
Total non-interest income for reportable segments	**38.3**	41.1
Losses on asset sales	**(4.8)**	(38.2)
Gain on sale of equity shares	**58.1**	-
Non-interest income	**91.6**	2.9
Comprising:		
Net fee and commission income	**20.1**	47.7
Income from investments	**0.2**	-
Other operating income/(expense)	**71.3**	(44.8)
	91.6	2.9
Operating expenses		
Total operating expenses for reportable segments	**(66.5)**	(80.8)
Operation and central costs	**(156.3)**	(182.1)
Project cost	**(134.2)**	(119.1)
Interest fair value unwind	**(3.2)**	(2.7)
Provision for conduct risk	**(18.9)**	(29.0)
Impairment re-classification	**(0.4)**	-
Other	**0.1**	0.1
Operating expenses	**(379.4)**	(413.6)
Interest fair value unwind		
Total interest unwind for reportable segments	**(97.2)**	(54.3)
Interest margin unwind	**93.8**	51.6
Impairment unwind	**0.2**	-
Operating expenses unwind	**3.2**	2.7
Interest fair value unwind	**-**	-
Impairment gains on loans and advances		
Total impairment gains on loans and advances for reportable segments	**11.6**	44.6
Impairment unwind	**(0.2)**	-
Losses on asset sales	**(6.8)**	-
Impairment gains on loans and advances	**4.6**	44.6

The 2015 comparatives have been re-presented as described in the Detailed Financial Review. They have been re-presented in respect of costs, including fraud costs, to reflect the way these are now managed and reported within the Bank.

	Core					Non-core			
As at 30 June 2016	**Retail**	**BaCB**	**Treasury**	**Other**	**Total Core**	**Corporate CoAM**	**Optimum**	**Total Non-core**	**Total**
Segment assets	**14,540.4**	**884.1**	**7,605.8**	**104.2**	**23,134.5**	**1,332.7**	**2,942.4**	**4,275.1**	**27,409.6**
Unallocated assets									**786.3**
Bank total assets									**28,195.9**

	Core					Non-core			
As at 30 June 2016	**Retail**	**BaCB**	**Treasury**	**Other**	**Total Core**	**Corporate CoAM**	**Optimum**	**Total Non-core**	**Total**
Segment liabilities	**19,117.2**	**2,691.9**	**4,221.1**	**101.8**	**26,132.0**	**162.2**	**-**	**162.2**	**26,294.2**
Unallocated liabilities									**604.9**
Bank total liabilities									**26,899.1**

Re-presented	Core					Non-core			
As at 31 December 2015	Retail	BaCB	Treasury	Other	Total Core	Corporate CoAM	Optimum	Total Non-core	Total
Segment assets	14,123.2	564.2	8,524.8	104.0	23,316.2	2,034.3	3,109.8	5,144.1	28,460.3
Unallocated assets									568.0
Bank total assets									29,028.3

Re-presented	Core					Non-core			
As at 31 December 2015	Retail	BaCB	Treasury	Other	Total Core	Corporate CoAM	Optimum	Total Non-core	Total
Segment liabilities	19,754.8	2,689.2	4,072.1	65.8	26,581.9	282.7	-	282.7	26,864.6
Unallocated liabilities									800.4
Bank total liabilities									27,665.0

Unallocated assets are assets which cannot be attributed to a reportable segment. The 2015 comparatives have been re-presented as more granular detail has become available on the segmentation of the balance sheet as a result of new financial systems.

4. Net interest income

	Period to 30 June 2016	Period to 30 June 2015
Interest receivable and similar income		
On financial assets not at fair value through profit or loss:		
On loans and advances to customers	**318.0**	402.1
On loans and advances to banks	**5.7**	10.1
On investment securities	**43.1**	31.6
Total of financial assets not at fair value through profit or loss	**366.8**	443.8
On financial assets at fair value through profit or loss:		
Net interest expense on financial instruments hedging assets	**(18.0)**	(36.3)
Net interest income on financial instruments not in a hedging relationship	**2.8**	8.2
Total interest receivable and similar income	**351.6**	415.7

	Period to 30 June 2016	Re-presented Period to 30 June 2015
Interest expense and similar charges		
On financial liabilities not at fair value through profit or loss:		
On customer accounts	**(81.3)**	(120.4)
On bank and other deposits	**(145.6)**	(127.6)
On subordinated liabilities	**(22.6)**	(11.6)
Total of financial liabilities not at fair value through profit or loss	**(249.5)**	(259.6)
On financial liabilities at fair value through profit or loss:		
Net interest income on financial instruments hedging liabilities	**4.0**	10.2
Net interest expense on financial instruments not in a hedging relationship	**(0.3)**	(4.4)

Total interest expense and similar charges	**(245.8)**	(253.8)

Interest expense on bank and other deposits includes interest expense on deposits by banks and on debt securities in issue. It also includes fair value unwind on debt securities in issue of £94.7m (30 June 2015: £66.4m), further details of which are provided in note 15.

The comparatives for interest expense on customer accounts and subordinated liabilities have been re-presented to more fairly reflect their nature.

5. Other operating income/(expense)

	Period to 30 June 2016	Re-presented Period to 30 June 2015
Profit/(loss) on sale of investment securities	**17.8**	-
Gain on sale of equity shares[1]	**58.1**	-
Loss on sale of loans and advances to customers	**(4.4)**	(34.0)
Income from derivatives and hedge accounting	**(47.8)**	(9.5)
Income from assets and liabilities held at fair value through profit and loss	**17.1**	10.9
Fair value movement on loans and advances to customers designated at fair value	**13.8**	(10.8)
Foreign exchange gains	**6.5**	3.5
Other	**10.2**	(4.9)
Total other operating income/(expense)	**71.3**	(44.8)

1. This gain has arisen as a result of the sale of the Bank's share in Visa Europe.

The comparatives of other operating income/(expense) have been re-presented to more fairly reflect their nature.

6. Operating expenses

	Period to 30 June 2016	Period to 30 June 2015
Operating expenses include:		
Staff costs	**142.2**	166.5
Administrative expenses	**91.7**	117.9

The following items are included in operating expenses, which have been incurred outside the ordinary course of business:

	Period to 30 June 2016	Period to 30 June 2015
Incurred outside the ordinary course of business		
Investment, integration and rationalisation costs	**41.5**	41.6
Bank separation costs	**38.9**	6.4
Total of items incurred outside the ordinary course of business	**80.4**	48.0

7. Income tax

	Period to 30 June 2016	Period to 30 June 2015
Current tax	**(2.3)**	33.4
Deferred tax	**(42.6)**	(4.5)
Total tax (credit)/charge	**(44.9)**	28.9

The tax on the Bank's loss before taxation differs from the theoretical amount that would arise using the corporation tax rate in the UK as follows:

	Period to 30 June 2016	Period to 30 June 2015
Loss before taxation	**(177.0)**	(204.2)
Tax calculated at a rate of 20% (30 June 2015: 20.25%)	**(35.4)**	(41.4)
Effects of:		
Impact of surcharge tax	**(11.5)**	-
Unrecognised deferred tax	**(6.3)**	40.4
Other differences	**4.4**	0.8
Expenses not deductible for tax purposes	**2.9**	0.1
Impact of corporation tax rate change	**2.8**	0.7
Group relief debtor movement	**(1.8)**	28.3
	(44.9)	28.9

Amounts receivable from The Co-operative Group for tax losses surrendered and changes in that amount are recorded as an adjustment to the tax expense. For further information on the group relief receivable, refer to note 2.

The movements on deferred tax are as follows:

	Period to 30 June 2016	Period to 31 December 2015
Deferred tax at the beginning of the period	**(40.2)**	(63.0)
Credited to the income statement	**42.6**	35.3
Charged to other comprehensive income	**(33.4)**	(12.5)
Deferred tax at the end of the period	**(31.0)**	(40.2)

The Directors consider the recoverability of deferred tax to be a critical accounting judgement as detailed in note 2.

Deferred tax assets totalling £350.4m (31 December 2015: £356.2m) have not been recognised where doubt exists over the availability of sufficient future taxable profits.

Reductions in the UK corporation tax rate from 20% to 19% (effective from 1 April 2017) and 18% (effective from 1 April 2020) were enacted in 2015. A banking surcharge tax of 8% applies to the Bank from 1 January 2016. On 16 March 2016, the Government announced a further reduction of the corporation tax rate to 17% effective from 1 April 2020; this change has not yet been enacted. Deferred tax has been calculated by reference to the most appropriate rate based on forecasts.

Tax legislation effective from 1 April 2015 restricts the proportion of banks' annual taxable profits that can be offset by tax losses arising prior to this date in relation to banking companies. The Government announced on 16 March 2016 that further restrictions on the utilisation of tax losses will be introduced effective from 1 April 2017; however the new legislation has not yet been enacted.

8. Non-current assets classified as held for sale

	As at 30 June 2016	As at 31 December 2015
Property, plant and equipment	**2.4**	3.4
Loans and advances to customers	**20.0**	-
	22.4	3.4

Loans and advances to customers held for sale arise as a result of a decision to sell a restructured syndicated loan.

9. a) Loans and advances to customers

	As at 30 June 2016	As at 31 December 2015
Gross loans and advances	**19,795.0**	19,935.6
Less: allowance for losses	**(199.6)**	(245.2)
	19,595.4	19,690.4

Loans and advances to customers include £198.5m (31 December 2015: £174.0m) of financial assets at fair value through profit or loss designated at initial recognition to eliminate or significantly reduce a measurement or recognition inconsistency, and £4.6m (31 December 2015: £4.2m) of financial assets held for trading. Of these, £128.7m (31 December 2015: £103.9m) are secured by real estate collateral.

Loans and advances to customers include £2.6bn (31 December 2015: £3.2bn) securitised under the Bank's securitisation and covered bond programmes. The Bank remains exposed to substantially all of the risks and rewards of ownership of these assets. Secured on these mortgage assets are £10.0m (31 December 2015: £10.1m) of deposits by banks and £1.9bn (31 December 2015: £2.3bn) of fixed and floating rate notes.

Concentration of exposure

The Bank's exposure is predominantly within the UK. Further information on the concentration of exposure is included within the Risk Management disclosures.

Allowance for losses on loans and advances

	Core		**Non-core**		
	Individual	**Collective**	**Individual**	**Collective**	**Total**
Period to 30 June 2016					
At the beginning of the period	**3.8**	**102.3**	**128.3**	**10.8**	**245.2**
Reclassification between collective & individual	**(2.8)**	**2.8**	**(9.9)**	**9.9**	**-**
(Release)/charge against profits[1]	**(0.1)**	**(1.3)**	**7.3**	**(1.7)**	**4.2**
Amounts written off	**(0.4)**	**(2.9)**	**(42.0)**	**(4.0)**	**(49.3)**
Unwind of discount allowance	**-**	**-**	**(0.5)**	**-**	**(0.5)**
At the end of the period	**0.5**	**100.9**	**83.2**	**15.0**	**199.6**

1. The movement in the allowance for losses on loans and advances in relation to balances with debt collection agencies is immaterial and is incorporated within the (release)/charge against profits for the period.

The £4.2m charge against profits as shown in the table above, reconciles to the net impairment gain as per the income statement, as shown below:

	Note	**As at 30 June 2016**	As at 31 December 2015
Net impairment gain shown in income statement		**(4.6)**	(48.6)
Amounts recovered against amounts previously written off		**9.0**	7.5
Transfer to loss on sale of assets – loans and receivables		**-**	(40.9)
Provision against fair value adjustment for hedged risk	9b	**(0.2)**	44.3
Charge/(release) against profits shown above		**4.2**	(37.7)

Core provisions are analysed in further detail below:

	Core						
	Retail		**BaCB**		**Other**		**Total**
	Individual	**Collective**	**Individual**	**Collective**	**Individual**	**Collective**	**Core**
Period to 30 June 2016							
At the beginning of the period	**2.8**	**101.5**	**1.0**	**0.8**	**-**	**-**	**106.1**
Reclassification between collective & individual	**(2.8)**	**2.8**	**-**	**-**	**-**	**-**	**-**
(Release)/charge against profits	**-**	**(1.9)**	**(0.1)**	**0.6**	**-**	**-**	**(1.4)**
Amounts written off	**-**	**(2.9)**	**(0.4)**	**-**	**-**	**-**	**(3.3)**
Unwind of discount allowance	**-**	**-**	**-**	**-**	**-**	**-**	**-**
At the end of the period	**-**	**99.5**	**0.5**	**1.4**	**-**	**-**	**101.4**

Non-core provisions are analysed in further detail below:

	Non-core				
	Corporate CoAM		**Optimum**		**Total**
	Individual	**Collective**	**Individual**	**Collective**	**Non-core**
Period to 30 June 2016					
At the beginning of the period	**118.4**	**7.5**	**9.9**	**3.3**	**139.1**
Reclassification between collective & individual	**-**	**-**	**(9.9)**	**9.9**	**-**
Charge/(release) against profits	**7.3**	**(6.7)**	**-**	**5.0**	**5.6**
Amounts written off	**(42.0)**	**-**	**-**	**(4.0)**	**(46.0)**
Unwind of discount allowance	**(0.5)**	**-**	**-**	**-**	**(0.5)**
At the end of the period	**83.2**	**0.8**	**-**	**14.2**	**98.2**

	Core		Non-core		
	Individual	Collective	Individual	Collective	Total
Year to 31 December 2015					
At the beginning of the period	4.5	110.0	396.3	29.1	539.9
Disposal of UTB	(2.1)	(0.5)	-	-	(2.6)
(Release)/charge against profits	(1.3)	4.2	(22.3)	(18.3)	(37.7)
Amounts written back/(written off)	2.7	(9.1)	(244.2)	-	(250.6)
Unwind of discount allowance	-	(2.3)	(1.5)	-	(3.8)
At the end of the period	3.8	102.3	128.3	10.8	245.2

Core provisions are analysed in further detail below:

	Core						
	Retail		BaCB		Other		Total
	Individual	Collective	Individual	Collective	Individual	Collective	Core
Year to 31 December 2015							
At the beginning of the period	1.0	107.3	1.4	2.2	2.1	0.5	114.5
Disposal of UTB	-	-	-	-	(2.1)	(0.5)	(2.6)
(Release)/charge against profits	(1.4)	5.6	0.1	(1.4)	-	-	2.9

Amounts written back/(written off)	3.2	(9.1)	(0.5)	-	-	-	(6.4)
Unwind of discount allowance	-	(2.3)	-	-	-	-	(2.3)
At the end of the period	2.8	101.5	1.0	0.8	-	-	106.1

Non-core provisions are analysed in further detail below:

	Non-core				
	Corporate CoAM		Optimum		Total
	Individual	Collective	Individual	Collective	Non-core
Year to 31 December 2015					
At the beginning of the period	386.8	16.7	9.5	12.4	425.4
Charge/(release) against profits	12.6	(9.2)	(34.9)	(9.1)	(40.6)
Amounts (written off)/written back	(279.5)	-	35.3	-	(244.2)
Unwind of discount allowance	(1.5)	-	-	-	(1.5)
At the end of the period	118.4	7.5	9.9	3.3	139.1

'Retail – Individual' and 'Optimum – Individual' both contain fair value reversals of £3.7m and £40.2m respectively. These balances are within the 'Amounts written off' rows within the above tables.

9. b) Fair value adjustments for hedged risk

The Bank has entered into interest rate swaps that protect it from fair value changes of its portfolio of fixed rate mortgages due to interest rate movements. Changes in the fair values of these swaps are offset by a change for an element of the fair value for the hedged risk.

	As at 30 June 2016	As at 31 December 2015
Gross fair value adjustments for hedged risk	**183.2**	98.0
Less: impairment provision	**(3.8)**	(4.0)
	179.4	94.0

Movements on impairment provision on fair value adjustments for hedged risk are shown below:

	Period ended 30 June 2016	Year ended 31 December 2015
At the beginning of the period	**4.0**	48.3
Release for the period	**(0.2)**	(44.3)
At the end of the period	**3.8**	4.0

10. Investment securities

Analysis of investment securities by issuer

	As at 30 June 2016	As at 31 December 2015
Investment securities issued by public bodies:		
Government securities	**1,758.4**	2,518.1
Other public sector securities	**145.1**	87.2
Total investment securities issued by public bodies	**1,903.5**	2,605.3
Other debt securities:		
Other floating rate notes	**443.3**	674.2
Mortgage backed securities	**1,395.4**	1,614.7
Total investment securities issued by other issuers	**1,838.7**	2,288.9
Total investment securities	**3,742.2**	4,894.2

Other floating-rate notes (FRNs) relate to sterling denominated FRNs with contractual maturities ranging from six months to seven years from the balance sheet date.

11. Provisions for liabilities and charges

Period to 30 June 2016	**Property**	**FSCS levies**	**PPI**	**Conduct/legal**	**Separation**	**Other**	**Total**
At the beginning of the period	**43.7**	**10.8**	**87.0**	**268.7**	**64.3**	**24.7**	**499.2**
Provided/(released) in the period:							
Interest income	**-**	**-**	**-**	**1.8**	**-**	**-**	**1.8**
Operating expense	**0.4**	**6.2**	**-**	**0.4**	**5.1**	**11.3**	**23.4**
Provision for customer redress	**-**	**-**	**33.5**	**(14.6)**	**-**	**-**	**18.9**

Utilised during the period	**(6.3)**	**-**	**(18.6)**	**(128.8)**	**(35.8)**	**(5.7)**	**(195.2)**
At the end of the period	**37.8**	**17.0**	**101.9**	**127.5**	**33.6**	**30.3**	**348.1**

Provisions were analysed as follows:							
Amounts falling due within one year	**16.5**	**9.0**	**40.4**	**116.5**	**28.4**	**29.9**	**240.7**
Amounts falling due after one year	**21.3**	**8.0**	**61.5**	**11.0**	**5.2**	**0.4**	**107.4**
Total provisions	**37.8**	**17.0**	**101.9**	**127.5**	**33.6**	**30.3**	**348.1**

Property
The Bank has a number of leasehold properties available for rent. Provisions are made when either the sub-lease income does not cover the rental expense or the property is vacant. The provision is based on the expected outflows during the remaining periods of the leases. In addition, dilapidation provisions are recorded to the extent that the Bank has incurred dilapidations and/or the dilapidation clause within the contract has been invoked.

Financial Services Compensation Scheme (FSCS) levies
In common with other regulated UK deposit takers, the Bank pays levies to the FSCS to enable the FSCS to meet claims against it. During 2008 and 2009 claims were triggered against the FSCS in relation to a number of financial institutions. The compensation paid out to consumers is currently funded through loans from HM Treasury. The Bank will be liable to pay a proportion of the outstanding borrowings that the FSCS has borrowed from HM Treasury. Additionally, the Bank is obliged to pay its share of management expenses and compensation based upon the Bank's proportion of the total market protected deposits at 31 December of each year.

The term of these loans was interest only for the first three years, with the FSCS recovering the interest cost, together with its own ongoing management expenses, through annual management levies on its members. The initial three year term expired in September 2011, and under the renegotiated terms the interest rate was reset from 12 month LIBOR +30bps to 12 month LIBOR +100bps.

By virtue of it holding deposits protected under the FSCS scheme the Bank has an obligation to pay levies in respect of the interest cost for 2015/16. The Bank has provided £17.0m as at 30 June 2016 (31 December 2015: £10.8m) for its share of the levies raised by the FSCS. The Bank's interest levy provision calculation includes estimates of the total FSCS levy in each levy year and estimates of the Bank's market participation in each levy year.

Payment Protection Insurance (PPI)
Provisions have been made in respect of potential customer compensation claims relating to past sales of PPI. Claims are investigated on an individual basis and, where appropriate, compensation payments are made. For a number of years the Bank, along with many other financial services providers, sold PPI alongside mortgage and non-mortgage credit products. The Bank stopped selling non-mortgage PPI in January 2009 and stopped selling mortgage PPI in March 2012.

The FSA issued a policy statement in August 2010, which amended the 'Disputes Resolution: Complaints' section of the FSA Handbook, setting out new rules for handling complaints, including complaints of PPI mis-selling. The Bank must comply with the policy statement which requires complainants to receive adequate redress and the Bank to deliver fair outcomes and treat customers fairly including non-complainants. An additional provision of £33.5m was recognised in the period ending 30 June 2016 (30 June 2015: £nil), in respect of the total expected cost to the Bank of carrying out this work and paying compensation. The provision increase reflects the Bank's initial impact assessment of the FCA's Consultation Paper CP16/20, which includes an extension of the proposed claim time bar end date to June 2019 and minor policy changes. As a result, the total provision raised by the Bank to date is £457.3m.

Conduct/legal provisions
During the period the Bank provided £1.8m (30 June 2015: £20.0m) in respect of interest income in relation to breaches of the technical requirements of the CCA.

The Bank released £14.6m (30 June 2015: £28.5m charge) of provision for customer redress. £12.5m of this release relates to breaches of the technical requirements of the CCA, following amendments to the underlying redress assumptions as the remediation programme nears completion. The remaining £2.1m release relates to £0.9m on Mortgages and £1.2m of other releases.

Other
The Bank is engaged in commercial contractual discussions with certain providers of outsourced services. Provisions have been recognised within other provisions above where the Bank is able reliably to estimate any financial liabilities associated with such discussions. The charge in the period primarily relates to a revised compensation structure for employees.

12. Pensions
The Bank participates in two multi-employer schemes - Pace and the Britannia Pension Scheme (BPS) - of which the former is shared with The Co-operative Group and other Group subsidiaries, and the latter is a scheme in which only the Bank and subsidiaries of the Bank participate. Both schemes have closed defined benefit sections, and small Bank-supported Employer Financed Retirement Benefit Schemes, all of which are closed to future benefit accrual. The Pace scheme is open to further contributions in its defined contribution section. Full details of the schemes are disclosed within the Bank's Annual Report and Accounts 2015.

The Co-operative Pension Scheme (Pace)

The Bank continues to account for this multi-employer scheme on a defined contribution basis as defined within the Bank's Annual Report and Accounts 2015. The Pace scheme triennial valuation as at 4 April 2013 was completed on 21 July 2014. The funding shortfall for the entire scheme had increased from £248m per the previous triennial valuation as at 6 April 2010 to £600m as at 4 April 2013.

The latest funding shortfall position calculated by the scheme actuary on an approximate basis as at 31 May 2014 was £104.0m, for which a deficit recovery plan was agreed between The Co-operative Group and the Pace Trustee. The Bank reimbursed the Group £5.0m for the period 2014/2015 and £5.0m for the period 2015/2016, and as of 3 August 2016 has committed to pay a further £5.0m to the period ending July 2017, by which point it anticipates an agreement on separation will have been reached. The next triennial valuation (as at 5 April 2016) is due to be agreed by 5 July 2017, the work for which is being conducted alongside separation activities.

Britannia Pension Scheme

The Britannia Pension Scheme is accounted for on a defined benefit basis in the Interim Financial Report 2016. During H1 2016, the Bank worked with the BPS Trustee, legal counsel and pensions advisors to clarify the position on the Bank's right to the refund of any surplus in the scheme were BPS to be wound up; in resolving this, it has recognised the accounting surplus of the BPS on the balance sheet.

The retirement benefits associated with the Britannia Pension Scheme recognised on the balance sheet comprise:

	Assets 30 June 2016	Assets 31 December 2015	**Liabilities 30 June 2016**	Liabilities 31 December 2015	**Net 30 June 2016**	Net 31 December 2015
Britannia Pension Scheme	**722.6**	720.3	**(640.9)**	(639.9)	**81.7**	80.4
Less asset limitation (IFRIC 14)	**-**	(80.4)	**-**	-	**-**	(80.4)
	722.6	639.9	**(640.9)**	(639.9)	**81.7**	-

The amounts recorded are as follows:

	As at 30 June 2016	As at 31 December 2015
Present value of funded obligations	**(640.9)**	(639.9)
Asset limitation (IFRIC14)	**-**	(80.4)
Fair value of plan assets	**722.6**	720.3
Net retirement benefit asset	**81.7**	-

The amounts recognised in the income statement are as follows:

	Period to 30 June 2016	Period to 30 June 2015
Current service cost	**-**	-
Interest expense on defined benefit obligation	**(12.3)**	(12.5)
Interest income on plan assets	**13.9**	13.4
Administrative expenses	**(0.8)**	(0.9)
	0.8	-

Changes in the present value of the defined benefits obligation are as follows:

	Period to 30 June 2016
As at 31 December 2015	**639.9**
Benefit payments from plan	**(11.3)**
Interest expense	**12.3**
30 June 2016	**640.9**

Changes in the fair value of the plan assets are as follows:

	Period to 30 June 2016
As at 31 December 2015	**720.3**

Interest income on plan assets	**13.9**
Employer contributions	**0.5**
Benefit payments from plan assets	**(11.3)**
Administrative expenses paid from plan assets	**(0.8)**
Return on plan assets (excluding interest income)	**-**
30 June 2016	**722.6**

	As at 30 June 2016	Restated As at 31 December 2015
The principal assumptions used to determine the defined benefit liabilities of the Britannia Pension Scheme are:		
Discount rate	**3.90%**	3.90%
Rate of increase in salaries	**-**	-
Future pension increases where capped at 5.0% per annum	**3.15%**	3.15%
Future pension increases where capped at 5.0% per annum, minimum 3.0%	**3.60%**	3.60%
Life expectancy:		
Female member currently aged 65 (current life expectancy)	**24.9**	24.7
Male member currently aged 65 (current life expectancy)	**22.8**	22.7
Female member currently aged 45 (life expectancy at age 65)	**27.2**	27.1
Male member currently aged 45 (life expectancy at age 65)	**25.1**	25.0

The principal assumptions used to determine the net pension cost of the Britannia defined benefit scheme are:		
Discount rate	**3.90%**	3.70%
Rate of increase in salaries	**-**	-

The comparative life expectancies have been updated to reflect the final actuarial table data applied in the liability calculation.

The Scheme Actuary completed an actuarial triennial valuation of BPS as at 5 April 2011 which showed that the scheme had a funding shortfall of £3.7m. CFSMS (the sponsoring employer) subsequently agreed to pay a lump sum of £3.7m to eliminate this shortfall. The 5 April 2014 Britannia Scheme triennial valuation is still being negotiated with the scheme Trustee – when this is finalised, the Bank may be required to pay deficit contributions in respect of the funding deficit in the scheme as at 5 April 2014. In July 2016, in recognition of the fact that the statutory deadline for completing the valuation was past due, the Bank made a lump sum payment of £5.0m to the scheme.

Employer Financed Retirement Benefit Schemes

The Bank has obligations to two Employer Financed Retirement Benefit Schemes (included in ‘other liabilities’ on the face of the balance sheet): one in respect of former Bank Executives (referred to in previous disclosures as the Bank (unfunded) pension scheme) and a second in respect of former Britannia Executives. The latter scheme (the Britannia Supplementary Pension and Life Assurance Plan (BSPLAP)) has no ongoing formal relationship with the Britannia Pension Scheme, so has been represented separately. The assumptions used to determine the liabilities of the heritage Bank EFRBS are the same as those used in determining the Pace liabilities, and the assumptions used to determine the liabilities of the heritage Britannia EFRBS are the same as those used in determining the Britannia Pension Scheme liabilities.

	Assets 30 June 2016	Assets 31 December 2015	**Liabilities 30 June 2016**	Liabilities 31 December 2015	**Net 30 June 2016**	Net 31 December 2015
Heritage Bank EFRBS	**-**	-	**(4.4)**	(4.4)	**(4.4)**	(4.4)
Heritage Britannia EFRBS	**-**	-	**(3.1)**	(3.1)	**(3.1)**	(3.1)
	-	-	**(7.5)**	(7.5)	**(7.5)**	(7.5)

13. Contingent liabilities

Details of contingent liabilities at 31 December 2015 were disclosed in note 35 in the 2015 Annual Report and Accounts. These included the following key areas: assets pledged, commitments under operating leases, indemnification agreement, conduct issues, CCA issues, sale of the Bank’s share in Visa Europe Limited, regulatory and other investigations, legal proceedings, mortgage securitisation representations and warranties (including Warwick Finance One and Warwick Finance Two), pensions, and tax treatment of separation.

In addition, the following new and updated contingent liabilities have been identified as significant to an understanding of the changes in financial position and performance of the Bank since 31 December 2015:

Sale of the Bank’s share in Visa Europe Limited (VE)

The sale of the Bank's share in VE completed on 21 June 2016. The existing Loss Sharing Agreement, an overview of which was disclosed in the 2015 Annual Report and Accounts, is not affected by the replacement of the earn-out with increased cash consideration that was agreed prior to completion.

14. Related party transactions

Other than as detailed below, related party transactions for H1 2016 are similar in nature to those disclosed in note 37 in the 2015 Annual Report and Accounts.

Britannia Supplementary Pension & Life Assurance Plan

On 23 June 2016, the Bank entered into a Deed of Substitution, Removal and Appointment of Trustee and Cessation of Participation relating to the BSPLAP with CFS Management Services Limited (CFSMS, a subsidiary of The Co-operative Group) and The Co-operative Group, a related party. Under the Deed, CFSMS was released from its obligations and liabilities as the sole sponsor, principal employer and trustee of the BSPLAP and the Bank replaced it as sole sponsor, principal employer and trustee in BSPLAP.

Master Services Agreement (MSA)

The Bank is currently a recipient of network services from The Co-operative Group under the MSA. A contract variation to extend the provision of these services to end 2017 was signed on 30 June 2016.

IT services

The Co-operative Group and CFSMS currently provide IT services to the Bank under the IT Master Services Agreement (ITSA). The original agreement was signed on 5 July 2012 and updated on 22 May 2013. As part of IT separation from The Co-operative Group a number of services have now been repatriated successfully back to the Bank in H1 2016. This required a number of amendments to the ITSA to reflect the current operating model. Further incremental amendments will be required as the IT separation programmes repatriate further services from The Co-operative Group to the Bank's future service providers.

Estates separation

The Co-operative Group currently provides estates services to the Bank under the MSA for Professional Services. As part of estates separation from The Co-operative Group, a number of property and facility management services have been successfully repatriated back to the Bank in H1 2016. Property and facilities management services are now provided by separate third party service providers. Further ancillary estates support services are due to be repatriated to the Bank as the estates separation programme repatriates further services from The Co-operative Group to the Bank's future service providers.

Balances with The Co-operative Group

The tables below provide an analysis of balances with The Co-operative Group and its undertakings at 30 June 2016 and 31 December 2015 and their location within the Bank's balance sheet.

	As at 30 June 2016			
	Loans and advances to customers	**Other assets**	**Customer accounts**	**Other liabilities**
The Co-operative Group Limited	**-**	**65.2**	**(95.7)**	**-**
The Co-operative Banking Group Ltd	**-**	**-**	**(0.9)**	**-**
Subsidiaries of The Co-operative Banking Group Ltd	**-**	**10.9**	**(1.6)**	**-**
	-	**76.1**	**(98.2)**	**-**

	As at 31 December 2015			
	Loans and advances to customers	Other assets	Customer accounts	Other liabilities
The Co-operative Group Limited	1.0	61.6	(100.1)	-
The Co-operative Banking Group Ltd	-	-	(0.3)	-
Subsidiaries of The Co-operative Banking Group Ltd	-	19.2	(4.6)	(6.1)
	1.0	80.8	(105.0)	(6.1)

15. Fair values of financial assets and liabilities

The fair values in this note are stated at a specific date and may be significantly different from the amounts which will actually be paid on the maturity or settlement dates of the instruments. The tables below analyse the balance sheet carrying values of financial assets and liabilities by classification.

Balance sheet categories	**Held for trading**	**Designated at fair value**	**Loans and receivables**	**Available for sale**	**Liabilities at amortised cost**	**Derivatives in a hedging relationship**	**Total**
As at 30 June 2016							
Assets							
Cash and balances at central banks	**-**	**-**	**2,282.6**	**-**	**-**	**-**	**2,282.6**
Loans and advances to banks	**-**	**-**	**1,138.8**	**-**	**-**	**-**	**1,138.8**

Loans and advances to customers	**4.6**	**198.5**	**19,392.3**	**-**	**-**	**-**	**19,595.4**
Fair value adjustments for hedged risk	**-**	**-**	**179.4**	**-**	**-**	**-**	**179.4**
Investment securities	**-**	**74.5**	**14.3**	**3,653.4**	**-**	**-**	**3,742.2**
Derivative financial instruments	**207.1**	**-**	**-**	**-**	**-**	**418.3**	**625.4**
Equity shares	**-**	**-**	**-**	**43.9**	**-**	**-**	**43.9**
Other assets	**-**	**-**	**234.7**	**-**	**-**	**-**	**234.7**
Total financial assets	**211.7**	**273.0**	**23,242.1**	**3,697.3**	**-**	**418.3**	**27,842.4**
Non-financial assets							**353.5**
Total assets							**28,195.9**
Liabilities							
Deposits by banks	**-**	**-**	**-**	**-**	**877.3**	**-**	**877.3**
Customer accounts	**-**	**-**	**-**	**-**	**22,048.4**	**-**	**22,048.4**
Customer accounts – capital bonds	**-**	**37.0**	**-**	**-**	**-**	**-**	**37.0**
Debt securities in issue	**-**	**-**	**-**	**-**	**2,304.2**	**-**	**2,304.2**
Derivative financial instruments	**231.5**	**-**	**-**	**-**	**-**	**341.1**	**572.6**
Other borrowed funds	**-**	**-**	**-**	**-**	**490.3**	**-**	**490.3**
Other liabilities	**-**	**-**	**-**	**-**	**40.6**	**-**	**40.6**
Total financial liabilities	**231.5**	**37.0**	**-**	**-**	**25,760.8**	**341.1**	**26,370.4**
Non-financial liabilities							**528.7**
Total liabilities							**26,899.1**
Capital and reserves							**1,296.8**
Total liabilities and equity							**28,195.9**

Whilst the Bank does not hold any derivative financial instruments that are considered ‘derivatives held for trading purposes’ as shown in the Bank’s 2015 Annual Report and Accounts, IAS 39 requires derivative financial instruments that are not in a hedging relationship to be classified as ‘held for trading’.

Fair value disclosures throughout this note have been calculated in accordance with IFRS 13, which values assets individually rather than as a portfolio.

Balance sheet categories	Held for trading	Designated at fair value	Loans and receivables	Available for sale	Liabilities at amortised cost	Derivatives in a hedging relationship	Total
As at 31 December 2015							
Assets							
Cash and balances at central banks	-	-	2,678.5	-	-	-	2,678.5
Loans and advances to banks	-	-	871.0	-	-	-	871.0
Loans and advances to customers	4.2	174.0	19,512.2	-	-	-	19,690.4
Fair value adjustments for hedged risk	-	-	94.0	-	-	-	94.0
Investment securities	-	582.4	15.0	4,296.8	-	-	4,894.2
Derivative financial instruments	147.9	-	-	-	-	222.2	370.1
Equity shares	-	-	-	55.6	-	-	55.6
Other assets	-	-	124.1	-	-	-	124.1
Total financial assets	152.1	756.4	23,294.8	4,352.4	-	222.2	28,777.9
Non-financial assets							250.4
Total assets							29,028.3
Liabilities							
Deposits by banks	-	-	-	-	725.9	-	725.9
Customer accounts	-	-	-	-	22,732.0	-	22,732.0
Customer accounts – capital bonds	-	77.4	-	-	-	-	77.4
Debt securities in issue	-	-	-	-	2,554.3	-	2,554.3
Derivative financial instruments	148.1	-	-	-	-	198.8	346.9
Other borrowed funds	-	-	-	-	459.9	-	459.9
Other liabilities	-	-	-	-	68.8	-	68.8
Total financial liabilities	148.1	77.4	-	-	26,540.9	198.8	26,965.2
Non-financial liabilities							699.8

Total liabilities	27,665.0
Capital and reserves	1,363.3
Total liabilities and equity	29,028.3

a) Use of financial instruments

The use of financial instruments is essential to the Bank's business activities, and financial instruments constitute a significant proportion of the Bank's assets and liabilities. The main financial instruments used by the Bank, and the purposes for which they are held, are outlined below:

Loans and advances to customers and customer accounts
The provision of banking facilities to customers is the primary activity of the Bank, and loans and advances to customers and customer accounts are major constituents of the balance sheet. Loans and advances to customers include Retail mortgages, Corporate loans, credit cards, unsecured Retail lending and overdrafts. Customer accounts include Retail and Corporate current and savings accounts.

Loans and advances to banks and investment securities
Loans and advances to banks and investment securities underpin the Bank's liquidity requirements and generate incremental net interest income. Held for trading investments are held for economic hedging purposes only as the Bank does not have an active trading book.

Deposits by banks and debt securities in issue
The Bank issues medium term notes within an established medium term note programme and can also issue certificates of deposit as part of its normal treasury activities.

In addition to this the Bank has issued notes additionally secured by mortgage assets through its Covered Bond programme and issued secured notes through a number of different securitisation SPEs.

Other borrowed funds
The Bank utilises a broad spread of long term wholesale funding in the form of fixed rate subordinated debt in addition to funding from ordinary share capital and retained earnings.

Derivatives
A derivative is a financial instrument that derives its value from an underlying rate or price such as interest rates, exchange rates and other market prices. Derivatives are an efficient means of managing market risk and limiting counterparty exposure. The Bank uses them mainly for hedging purposes and to meet the needs of customers.

The most frequently used derivative contracts are interest rate swaps, exchange traded futures and options, caps and floors, currency swaps and forward currency transactions. Terms and conditions are determined by using standard industry documentation. Derivatives are subject to the same market and credit risk control procedures as are applied to other wholesale market instruments and are aggregated with other exposures to monitor total counterparty exposure, which is managed within approved limits for each counterparty.

Foreign exchange
The Bank undertakes foreign exchange dealing to facilitate customer requirements and to economically hedge balance sheet exposure to foreign currencies. The risk is managed formally within position limits which are set by ALCO, to which authority is delegated by the Board.

b) Valuation of financial assets and liabilities at fair value

The following tables analyse financial assets and liabilities carried at fair value by the three level fair value hierarchy defined as follows:
- Level 1 – Quoted market prices in active markets
- Level 2 – Valuation techniques using observable inputs
- Level 3 – Valuation techniques using unobservable inputs

	Fair value at end of the reporting period using:			
	Level 1	**Level 2**	**Level 3**	**Total**
As at 30 June 2016				
Non-derivative financial assets				
Held for trading:				
Loans and advances to customers	**-**	**4.6**	**-**	**4.6**
Designated at fair value:				
Loans and advances to customers	**-**	**193.2**	**5.3**	**198.5**
Investment securities	**74.5**	**-**	**-**	**74.5**
Available for sale financial assets:				
Investment securities	**2,272.3**	**-**	**1,381.1**	**3,653.4**
Equity shares	**0.1**	**27.7**	**16.1**	**43.9**
Derivative financial assets	**-**	**625.4**	**-**	**625.4**
Non-financial assets				

Investment properties	**-**	**-**	**2.2**	**2.2**
Total assets carried at fair value	**2,346.9**	**850.9**	**1,404.7**	**4,602.5**
Non-derivative financial liabilities				
Designated at fair value:				
Customer accounts – capital bonds	**-**	**37.0**	**-**	**37.0**
Derivative financial liabilities	**-**	**572.6**	**-**	**572.6**
Total liabilities carried at fair value	**-**	**609.6**	**-**	**609.6**

	Fair value at end of the reporting period using:			
	Level 1	Level 2	Level 3	Total
As at 31 December 2015				
Non-derivative financial assets				
Held for trading:				
Loans and advances to customers	-	4.2	-	4.2
Designated at fair value:				
Loans and advances to customers	-	168.5	5.5	174.0
Investment securities	582.4	-	-	582.4
Available for sale financial assets:				
Investment securities	2,697.0	-	1,599.8	4,296.8
Equity shares	0.1	4.3	51.2	55.6
Derivative financial assets	-	370.1	-	370.1
Non-financial assets				
Investment properties	-	-	2.1	2.1
Total assets carried at fair value	3,279.5	547.1	1,658.6	5,485.2
Non-derivative financial liabilities				
Designated at fair value:				
Customer accounts – capital bonds	-	77.4	-	77.4
Derivative financial liabilities	-	346.9	-	346.9
Total liabilities carried at fair value	-	424.3	-	424.3

The carrying values of financial instruments measured at fair value are determined in compliance with the accounting policies in note 1 and according to the following hierarchy:

Level 1 – Quoted market prices in active markets
Financial instruments with quoted prices for identical instruments in active markets. The best evidence of fair value is a quoted market price in an actively traded market.

Level 2 – Valuation techniques using observable inputs
Financial instruments with quoted prices for similar instruments in active markets or quoted prices for identical or similar instruments in inactive markets and financial instruments valued using models where all significant inputs are observable.

The valuation techniques used to value these instruments employ only observable market data and relate to the following assets and liabilities:

Loans and advances to customers
Loans and advances to customers primarily relate to Corporate loans of £187.5m (31 December 2015: £159.1m), which are fair valued through profit or loss using observable inputs. Loans held at fair value are valued at the sum of all future expected cash flows, discounted using a yield curve based on observable market inputs.

Investment securities – available for sale
Fair value is based on available market prices. Where this information is not available, fair value has been estimated using quoted market prices for securities with similar credit, maturity and yield characteristics.

Derivative financial instruments
Over-the-counter (i.e. non-exchange traded) derivatives are valued using valuation models which are based on observable market data. Valuation models calculate the present value of expected future cash flows, based upon ‘no arbitrage’ principles. The Bank enters into vanilla foreign exchange and interest rate swap derivatives, for which modelling techniques are standard across the industry. Examples of inputs that are generally observable include foreign exchange spot and forward rates, and benchmark interest rate curves.

Customer accounts – capital bonds
The estimated fair value of customer accounts – capital bonds is based on independent third party valuations using forecast future movements

in the appropriate indices.

Equity shares
Equity shares relate to investments held in VocaLink Holdings Limited and Unity Trust Bank plc, both of which are unquoted shares. For VocaLink, the valuation of these shares is based on offers received for the Bank's shareholding as the best indicator of the fair value of these shares at the reporting date. For Unity Trust Bank, the valuation of these shares is based on the Bank's sale of 20.0% shareholding in Unity Trust Bank in December 2015, which is the latest available pricing information for these shares.

Level 3 – Valuation techniques using unobservable inputs
This is used for financial instruments valued using models where one or more significant inputs are not observable.

The small proportion of financial assets valued based on significant unobservable inputs are analysed as follows:

Loans and advances to customers
Loans and advances to customers include 25 year fixed rate mortgages of £5.3m (31 December 2015: £5.5m), which are fair valued through profit or loss using unobservable inputs. 25 year fixed rate mortgages are valued using future interest cash flows at the fixed customer rate and estimated schedule of customer repayments. Cash flows are discounted at a credit adjusted discount rate; the credit adjustment is based on the average margin of new long dated (five years or greater) fixed rate business written in the last six months, and subject to quarterly review. The eventual timing of future cash flows may be different from that forecast due to unpredictable customer behaviour, particularly on a 25 year product. The valuation methodology takes account of credit risk and has increased the valuation by £0.1m in H1 2016 (H1 2015: no change). A reasonable change in the assumptions would not result in any material change in the valuation.

Investment securities – available for sale
Investment securities – available for sale include MBS of £1,381.1m (31 December 2015: £1,599.8m), which are fair valued through other comprehensive income. The Bank uses an independent third party valuation agent which provides prices obtained from large financial institutions. These prices are indicative values only and do not represent an offer to purchase the securities.

The Bank owns a significant portion of the MBS issuance and the trading volume of the remaining portions in the market is not readily available. These MBS represent the Bank's interest in unconsolidated structured entities.

A 1% increase or decrease in the price of the notes will result in the value increasing or decreasing by approximately £13.8m respectively.

Equity shares
Equity shares include the Bank's US Dollar denominated convertible preference shares in Visa International, which are classified as available for sale, with any movements in fair value being recognised through other comprehensive income. The fair value of the Visa International shares has been calculated by taking the period end NYSE share price and discounting for illiquidity and clawback.

If the illiquidity premium to the discount rate was assumed to be double, it would result in a reduction in the overall fair value of the equity shares of £2.5m (4.5%) at 30 June 2016. Therefore, this valuation model is not deemed to be materially sensitive to this input, with a 100% increase resulting in a 4.5% change in valuation.

Investment properties
Investment properties within level 3 are valued by using the original price, index linked at the balance sheet date using the relevant house price index.

Movements in fair values of instruments with significant unobservable inputs (level 3) were:

	Fair value at the beginning of the period	Purchases and transfers in	Sales, transfers out and repayments	Other comprehensive income	Income statement	Fair value at the end of the period
Period to 30 June 2016						
Loans and advances to customers	**5.5**	**-**	**(0.3)**	**-**	**0.1**	**5.3**
Investment securities	**1,599.8**	**-**	**(210.9)**	**(9.3)**	**1.5**	**1,381.1**
Equity shares	**51.2**	**16.1**	**(58.1)**	**10.2**	**(3.3)**	**16.1**
Investment properties	**2.1**	**-**	**-**	**-**	**0.1**	**2.2**
	1,658.6	**16.1**	**(269.3)**	**0.9**	**(1.6)**	**1,404.7**
Year to 31 December 2015						
Loans and advances to customers	6.7	-	(1.0)	-	(0.2)	5.5
Investment securities	-	1,685.5	(86.8)	1.1	-	1,599.8
Equity shares	-	-	-	51.2	-	51.2
Investment properties	2.1	-	(0.1)	-	0.1	2.1
	8.8	1,685.5	(87.9)	52.3	(0.1)	1,658.6

c) Fair values of financial assets and liabilities not carried at fair value

The carrying values of financial instruments measured at amortised cost are determined in compliance with the accounting policies in note 1.

The table below sets out a summary of the carrying and fair values of:
- financial assets classified as loans and receivables; and
- financial liabilities classified as held at amortised cost,

unless there is no significant difference between carrying and fair values.

	Core				Non-core				
Carrying value	**Retail**	**BaCB**	**Treasury**	**Total Core**	**Corporate CoAM**	**Optimum**	**Total Non-core**	**Unallocated**	**Total**
As at 30 June 2016									
Financial assets									
Loans and advances to banks	**-**	**-**	**1,138.8**	**1,138.8**	**-**	**-**	**-**	**-**	**1,138.8**
Loans and advances to customers	**14,570.6**	**892.0**	**-**	**15,462.6**	**1,202.0**	**2,727.7**	**3,929.7**	**-**	**19,392.3**
Fair value adjustments to hedged risk	**183.1**	**-**	**-**	**183.1**	**(3.7)**	**-**	**(3.7)**	**-**	**179.4**
Investment securities	**-**	**-**	**14.3**	**14.3**	**-**	**-**	**-**	**-**	**14.3**
Other assets	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**234.7**	**234.7**
Financial liabilities									
Deposits by banks	**-**	**-**	**877.3**	**877.3**	**-**	**-**	**-**	**-**	**877.3**
Customer accounts	**19,182.1**	**2,691.9**	**12.2**	**21,886.2**	**162.2**	**-**	**162.2**	**-**	**22,048.4**
Debt securities in issue	**-**	**-**	**2,304.2**	**2,304.2**	**-**	**-**	**-**	**-**	**2,304.2**
Other borrowed funds	**-**	**-**	**490.3**	**490.3**	**-**	**-**	**-**	**-**	**490.3**
Other liabilities	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**40.6**	**40.6**

	Core				Non-core				
Fair value	**Retail**	**BaCB**	**Treasury**	**Total Core**	**Corporate CoAM**	**Optimum**	**Total Non-core**	**Unallocated**	**Total**
As at 30 June 2016									
Financial assets									
Loans and advances to banks	**-**	**-**	**1,138.8**	**1,138.8**	**-**	**-**	**-**	**-**	**1,138.8**
Loans and advances to customers	**14,858.6**	**759.8**	**-**	**15,618.4**	**1,051.2**	**2,275.6**	**3,326.8**	**-**	**18,945.2**
Fair value adjustments to hedged risk	**183.1**	**-**	**-**	**183.1**	**(3.7)**	**-**	**(3.7)**	**-**	**179.4**
Investment securities	**-**	**-**	**12.4**	**12.4**	**-**	**-**	**-**	**-**	**12.4**
Other assets	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**234.7**	**234.7**
Financial liabilities									
Deposits by banks	**-**	**-**	**877.3**	**877.3**	**-**	**-**	**-**	**-**	**877.3**
Customer accounts	**19,209.0**	**2,693.5**	**12.2**	**21,914.7**	**162.2**	**-**	**162.2**	**-**	**22,076.9**
Debt securities in issue	**-**	**-**	**2,493.2**	**2,493.2**	**-**	**-**	**-**	**-**	**2,493.2**
Other borrowed funds	**-**	**-**	**453.3**	**453.3**	**-**	**-**	**-**	**-**	**453.3**
Other liabilities	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**40.6**	**40.6**

	Core				Non-core				
Carrying value	Retail	BaCB	Treasury	Total Core	Corporate CoAM	Optimum	Total Non-core	Unallocated	Total
As at 31 December 2015									
Financial assets									
Loans and advances to banks	-	-	871.0	871.0	-	-	-	-	871.0
Loans and advances to customers	14,257.1	576.5	-	14,833.6	1,817.3	2,861.3	4,678.6	-	19,512.2
Fair value adjustments to hedged risk	98.0	-	-	98.0	(4.0)	-	(4.0)	-	94.0

Investment securities	-	-	15.0	15.0	-	-	-	-	15.0
Other assets	-	-	-	-	-	-	-	124.1	124.1
Financial liabilities									
Deposits by banks	-	-	725.9	725.9	-	-	-	-	725.9
Customer accounts	19,838.7	2,682.0	-	22,520.7	211.3	-	211.3	-	22,732.0
Debt securities in issue	-	-	2,554.3	2,554.3	-	-	-	-	2,554.3
Other borrowed funds	-	-	459.9	459.9	-	-	-	-	459.9
Other liabilities	-	-	-	-	-	-	-	68.8	68.8

	Core				Non-core				
Fair value	Retail	BaCB	Treasury	Total Core	Corporate CoAM	Optimum	Total Non-core	Unallocated	Total
As at 31 December 2015									
Financial assets									
Loans and advances to banks	-	-	871.0	871.0	-	-	-	-	871.0
Loans and advances to customers	14,429.3	559.5	-	14,988.8	1,659.4	2,556.6	4,216.0	-	19,204.8
Fair value adjustments to hedged risk	98.0	-	-	98.0	(4.0)	-	(4.0)	-	94.0
Investment securities	-	-	13.3	13.3	-	-	-	-	13.3
Other assets	-	-	-	-	-	-	-	124.1	124.1
Financial liabilities									
Deposits by banks	-	-	725.9	725.9	-	-	-	-	725.9
Customer accounts	19,842.2	2,683.5	-	22,525.7	211.3	-	211.3	-	22,737.0
Debt securities in issue	-	-	2,882.7	2,882.7	-	-	-	-	2,882.7
Other borrowed funds	-	-	498.7	498.7	-	-	-	-	498.7
Other liabilities	-	-	-	-	-	-	-	68.8	68.8

Key considerations in the calculation of fair values for loans and receivables and financial liabilities at amortised cost are as follows:

Loans and advances to banks/deposits by banks
Loans and advances to banks include interbank placements and items in the course of collection.

The amortised cost value of all loans and advances to banks are deemed to be a close approximation of their fair value due to their short maturity. The estimated fair value of fixed interest bearing deposits is based on discounted cash flows using prevailing money market interest rates for debts with similar credit risk and remaining maturity.

Loans and advances to customers
The fair value of loans and advances to customers in total is 98% of the carrying value as at 30 June 2016. The overall fair value is less than par primarily due to two main factors for Non-core loans in particular:

- customer interest rates are below the market rate for the period until expected maturity or the repricing date, if earlier; and
- credit risk adjustments due to incurred and expected future credit losses.

The fair value of loans and advances to customers is calculated by segmenting the overall balance into Retail, Optimum and Corporate:

- **Retail**

  Fixed rate loans and advances to customers are revalued to fair value based on future interest cash flows (at funding rates) and principal cash flows discounted using an appropriate market rate. The market rate applied in the calculation is the average market rate for new originations of mortgages with similar characteristics to the book of mortgages being valued. This rate is assumed to encompass the time value of money, plus a risk premium to account for the inherent uncertainty in the timing and amount of future cash flows arising from a book of mortgage assets.

  Forecast principal repayments are based on redemption at the earlier of maturity or re-pricing date with some overlay for historical behavioural experience where relevant. The eventual timing of future cash flows may be different from the forecast due to unpredictable customer behaviour. It is assumed that there would be no other factors which market participants would take into account when assessing the fair value of the Retail mortgage assets. It is assumed that there is no fair value adjustment required in respect of interest rate movement on standard variable rate mortgage assets, as the interest rate being charged is assumed to be equal to the market rate for those mortgage assets.

- **Optimum**

Fair values have been calculated using the future lifetime income approach. Under this approach, fair value is measured by determining discounted expected cash flows, derived using expected redemption profiles of the portfolio and discounting these cash flows at current market rates for products with similar characteristics and risk profiles. The current market rate used is assumed to encompass the time value of money, plus a risk premium to account for the inherent uncertainty in the timing and amount of future cash flows arising from a book of mortgage assets.

- **Corporate**

  For corporate assets an expected cash flow income approach has been used. Under this approach, value is measured by determining expected cash flows, derived using redemption profiles, from the portfolio and then considering credit costs, funding costs and tax to derive equity cash flows which are discounted at an appropriate blended cost of capital. The blended cost of capital is taken as an average of quoted cost of capital of the five largest listed banks in the UK, as this is assumed to represent the rate at which market participants would discount the future cash flows of a portfolio of corporate loans when assessing the fair value of such a portfolio.

Investment securities

Fair value is based on available market prices. Where this information is not available, fair value has been estimated using quoted market prices for securities with similar credit, maturity and yield characteristics.

Customer accounts

The estimated fair value of deposits with no stated maturity, which includes non-interest bearing deposits, is the amount repayable on demand. The estimated fair value of fixed interest bearing deposits and other borrowings without quoted market prices is based on future interest cash flows (at funding rates) and principal cash flows, discounted using an appropriate market rate.

Debt securities in issue and other borrowed funds

The aggregate fair values calculated are based on quoted market prices. For those notes for which quoted market prices are not available, fair value has been estimated using quoted market prices for securities with similar credit, maturity and yield characteristics. Quoted prices may be from inactive markets.

The fair value of debt securities in issue is significantly above the carrying value as a result of the carrying value being net of merger fair value adjustments. The carrying values of debt securities in issue are expected to increase as the merger fair value adjustments continue to unwind, as shown in the following section.

Unwind of merger fair value adjustments

On the merger of the Bank and Britannia Building Society in August 2009 an exercise was undertaken to fair value the respective assets and liabilities of Britannia Building Society. These fair value adjustments are unwound on an EIR basis over the expected lives of the assets and liabilities. As at 30 June 2016, the remaining merger fair value unwinds and the forecast unwind profiles can be summarised as follows:

				Forecast unwind			
	Carrying amount at period end	Remaining merger fair value to be unwound at period end	Actual unwind for the 6 month period to 30 June 2016	6 month period to 31 December 2016	2017	2018	2019+
As at 30 June 2016							
Assets							
Loans and advances to customers	**19,595.4**	**(20.4)**	**0.5**	**(1.1)**	**(2.1)**	**(1.9)**	**(15.3)**
Fair value adjustment for hedged risk	**179.4**	**(8.6)**	**(1.2)**	**(0.9)**	**(1.7)**	**(1.4)**	**(4.6)**
Other	**8,421.1**	**16.4**	**3.2**	**2.1**	**4.3**	**4.3**	**5.7**
Total assets	**28,195.9**	**(12.6)**	**2.5**	**0.1**	**0.5**	**1.0**	**(14.2)**
Liabilities							
Debt securities in issue	**2,304.2**	**(140.4)**	**(94.7)**	**(82.0)**	**(58.4)**	**-**	**-**
Deferred tax liabilities	**31.3**	**28.8**	**16.1**	**16.6**	**11.7**	**(0.1)**	**0.6**
Other	**24,563.6**	**-**	**-**	**-**	**-**	**-**	**-**
Total liabilities	**26,899.1**	**(111.6)**	**(78.6)**	**(65.4)**	**(46.7)**	**(0.1)**	**0.6**

A breakdown of the unwind on debt securities in issue held at merger is as follows:

							Forecast unwind	
Issue name	Issue date	Expected maturity date	Carrying amount at period end	Fair value at period end	Remaining merger fair value to be unwound at period end	Actual unwind for the 6 month period to 30 June 2016	6 month period to 31 December 2016	2017
As at 30 June 2016								
Leek Finance Number Seventeen plc	April 2006	June 2016	**-**	**-**	**-**	**29.5**	**-**	**-**

Leek Finance Number Eighteen plc	October 2006	December 2016	**703.1**	**721.5**	**39.3**	**32.7**	**39.3**	**-**
Leek Finance Number Nineteen plc	April 2007	June 2017	**694.5**	**708.7**	**102.9**	**34.1**	**44.0**	**58.9**
Total Leek Notes			**1,397.6**	**1,430.2**	**142.2**	**96.3**	**83.3**	**58.9**

Of which liabilities held internally within the Bank are as follows:

					Forecast unwind	
Issue name	**Carrying amount at period end**	**Fair value at period end**	**Remaining merger fair value to be unwound at period end**	**Actual unwind for the 6 month period to 30 June 2016**	**6 month period to 31 December 2016**	**2017**
As at 30 June 2016						
Internally held Leek Notes	**380.9**	**378.4**	**1.8**	**1.6**	**1.3**	**0.5**

Fair values of financial assets and liabilities which are not carried at fair value and bases of valuation
Fair values are determined according to the hierarchy set out above.

		Fair Value		
	Carrying value	**Level 1**	**Level 2**	**Level 3**
As at 30 June 2016				
Financial assets				
Loans and advances to banks	**1,138.8**	**-**	**1,138.8**	**-**
Loans and advances to customers	**19,392.3**	**-**	**-**	**18,945.2**
Fair value adjustment for hedged risk	**179.4**	**-**	**-**	**179.4**
Investment securities	**14.3**	**12.4**	**-**	**-**
Financial liabilities				
Deposits by banks	**877.3**	**-**	**877.3**	**-**
Customer accounts	**22,048.4**	**-**	**22,076.9**	**-**
Debt securities in issue	**2,304.2**	**1,280.6**	**1,212.6**	**-**
Other borrowed funds	**490.3**	**-**	**453.3**	**-**

The carrying amount is a reasonable approximation of fair value for the following assets and liabilities: loans and advances to banks, other assets, deposits by banks and other liabilities.

		Fair Value		
	Carrying value	Level 1	Level 2	Level 3
Re-presented as at 31 December 2015				
Financial assets				
Loans and advances to banks	871.0	-	871.0	-
Loans and advances to customers	19,512.2	-	-	19,204.8
Fair value adjustment for hedged risk	94.0	-	-	94.0
Investment securities	15.0	13.3	-	-
Financial liabilities				
Deposits by banks	725.9	-	725.9	-
Customer accounts	22,732.0	-	22,737.0	-
Debt securities in issue	2,554.3	1,307.3	1,575.4	-
Other borrowed funds	459.9	-	498.7	-

d) Fair value of transferred assets and associated liabilities

Securitisation vehicles
The beneficial ownership of the loans and advances to customers sold to securitisation vehicles by the subsidiaries of the Bank fail the derecognition criteria, and consequently these loans remain on the balance sheets of the sellers. Each seller therefore recognises a deemed loan financial liability on its balance sheet and an equivalent deemed loan asset is held on each securitisation company's balance sheet. The deemed loans are repaid as and when principal repayments are made by customers against these transferred loans and advances.

The securitisation vehicles have issued fixed and floating rate notes which are secured on the loans and advances to customers. The notes are redeemable in part from time to time, such redemptions being limited to the net capital received from mortgagors in respect of the underlying assets.

The Bank retains substantially all of the risks and rewards of ownership. The Bank benefits to the extent to which surplus income generated by the transferred mortgage portfolios exceeds the administration costs of those mortgages. The Bank continues to bear the credit risk of these mortgage assets.

The table below shows the carrying values and fair values of the assets transferred to securitisation vehicles and their associated liabilities. The carrying values presented below are the carrying amounts as recorded in the books of the subsidiary companies. Some of these issued notes are held internally by the Bank and as such are not shown in the consolidated balance sheet of the Bank.

	Carrying amount of transferred assets not derecognised	Carrying amount of associated liabilities	Fair value of transferred assets not derecognised	Fair value of associated liabilities	Net fair value position
As at 30 June 2016					
Leek Finance Number Seventeen plc[1]	**-**	**-**	**-**	**-**	**-**
Leek Finance Number Eighteen plc	**599.6**	**703.1**	**577.6**	**721.5**	**(143.9)**
Leek Finance Number Nineteen plc	**583.6**	**694.5**	**572.4**	**708.7**	**(136.3)**
Silk Road Finance Number Three plc	**308.1**	**311.6**	**305.5**	**311.8**	**(6.3)**
Meerbrook Finance Number Eight plc	**338.9**	**331.1**	**338.8**	**324.6**	**14.2**
	1,830.2	**2,040.3**	**1,794.3**	**2,066.6**	**(272.3)**

1. Leek 17 is nil at H1 2016 because this securitisation unwound during H1.

The above carrying amount of associated liabilities can be reconciled to debt securities in issue, as follows:

	Carrying value
Carrying amount of associated liabilities as given above	**2,040.3**
Internally held fixed and floating rate notes	**(488.9)**
Loan facilities and subdebt not included in debt securities in issue	**(285.8)**
Non-securitised debt securities	**1,137.2**
Merger fair value adjustment	**(148.5)**
Other adjustments	**49.9**
Debt securities in issue per consolidated balance sheet	**2,304.2**

Of the notes listed above, those held by the Bank are as follows:

	Carrying amount of transferred assets not derecognised	Carrying amount of associated liabilities	Fair value of transferred assets not derecognised	Fair value of associated liabilities	Net fair value position
As at 30 June 2016					
Leek Finance Number Seventeen plc	**-**	**-**	**-**	**-**	**-**
Leek Finance Number Eighteen plc	**161.2**	**189.1**	**194.0**	**187.4**	**6.6**
Leek Finance Number Nineteen plc	**161.2**	**191.8**	**195.7**	**191.0**	**4.7**
Silk Road Finance Number Three plc	**106.8**	**108.0**	**108.1**	**106.7**	**1.4**
	429.2	**488.9**	**497.8**	**485.1**	**12.7**

The above carrying value and fair value of assets held for each entity has been determined by applying the proportion of internally held liabilities.

Transferred assets include securitised gilts and loans and advances to customers that have not been derecognised by the seller. The associated liabilities include the fixed and floating rate notes, bank loans and intercompany loans that specifically relate to the funding for the assets securitised.

The fair value to carrying value ratio of the mortgages that have been securitised within Leek 18 and 19 is lower than the fair value to carrying value ratio for the associated liabilities. This is because it is expected that the notes will be repaid at par at the call date of the Leek liabilities, whereas most of the mortgages will continue to be held on the Bank's balance sheet for a significant period after the notes have been repaid and these mortgages have an interest rate which is below the equivalent market rate at the balance sheet date for loans of a similar nature.

The securitisation vehicles receive cash daily in relation to the transferred loans and advances and semi-annually for the transferred gilts. These amounts are held within loans and advances to banks until the associated liabilities' payments are due. Payments are made quarterly for all associated liabilities except for the variable funding notes associated with the transferred gilts, which are paid semi-annually. The amounts held within loans and advances to banks are not included in the table above but will be used in part to cover the repayments made on the associated liabilities.

The following table provides the fair value of the transferred assets and associated liabilities for 2015:

	Carrying amount of transferred assets not derecognised	Carrying amount of associated liabilities	Fair value of transferred assets not derecognised	Fair value of associated liabilities	Net fair value position
As at 31 December 2015					
Leek Finance Number Seventeen plc	525.1	536.0	497.1	548.7	(51.6)
Leek Finance Number Eighteen plc	633.3	687.3	615.4	698.5	(83.1)
Leek Finance Number Nineteen plc	617.0	676.1	600.0	681.2	(81.2)
Silk Road Finance Number Three plc	343.9	351.2	342.7	350.6	(7.9)
Meerbrook Finance Number Eight plc	377.7	364.0	379.5	366.6	12.9
	2,497.0	2,614.6	2,434.7	2,645.6	(210.9)

Covered Bond Limited Liability Partnerships

Moorland Covered Bonds LLP was established as a result of a £1.4bn covered bond retained issuance. Loans and advances to customers of £1.9bn were transferred to Moorland Covered Bonds LLP. The transfer was funded by a loan of £1.4bn and capital contribution of £0.5bn. During October 2011 the £1.4bn loan was repaid. Following additional capital contribution repayment and on achieving Regulated Covered Bond status there was a public issuance of notes in November 2011 totalling £0.6bn. At the period end the Bank held a loan of £0.6bn (31 December 2015: £0.6bn) and a capital contribution of £0.5bn (31 December 2015: £0.6bn) with Moorland Covered Bonds LLP.

Moorland Covered Bonds LLP does not have ordinary share capital. The Bank's interest in Moorland Covered Bonds LLP is in substance no different from a wholly owned subsidiary and consequently it is fully consolidated in the Bank's accounts. The table below shows the carrying values and fair values of the assets transferred to the covered bond and their associated liabilities:

	Carrying amount of transferred loans and advances to customers	**Carrying amount of fixed and floating rate notes**	**Fair value of transferred loans and advances to customers**	**Fair value of fixed and floating rate notes**	**Net fair value position**
As at 30 June 2016					
Moorland Covered Bonds LLP	**1,060.2**	**597.2**	**1,052.5**	**668.4**	**384.1**
As at 31 December 2015					
Moorland Covered Bonds LLP	1,215.4	596.9	1,222.6	668.1	554.5

Assets pledged

Assets are pledged as collateral under repurchase agreements with other banks. These deposits are not available to finance the Bank's day-to-day operations.

	Carrying amount of assets not derecognised	**Carrying amount of associated liabilities**	**Fair value of assets not derecognised**	**Fair value of associated liabilities**	**Net fair value position**
As at 30 June 2016					
Investments securities sold under repurchase agreements	**910.9**	**829.8**	**910.9**	**829.8**	**81.1**
As at 31 December 2015					
Investments securities sold under repurchase agreements	721.7	671.2	721.7	671.2	50.5

Associated liabilities are included within deposits by banks.

Assets sold under repurchase agreements include mortgage backed securities (£385.1m of assets and associated liabilities of £306.3m) and UK government gilts (£525.8m of assets and associated liabilities of £523.5m).

16. Post balance sheet events

It is a requirement of IAS 10 (Events after the balance sheet date) that this Financial Report reflects events arising after 30 June 2016. The following events have occurred between 30 June 2016 and 17 August 2016 (the date of approval of this Financial Report) and represent 'non adjusting' post balance sheet events:

Silk Road Finance Number 3 plc, a fully consolidated SPV, has given notice on 25 July 2016 to investors that it will redeem all outstanding Class A Notes on 21 September 2016. The Class A notes outstanding at the date of redemption are expected to be £203.6m.

Investor call

An investor call will be held as follows:
Date: Thursday 18 August 2016
Time: 9.30 am
Dial: +44 (0) 20 3059 8125
A webcast will also be available at www.co-operativebank.co.uk/investorrelations

An operator will assist you in joining the call.

Investor enquiries:
Jonathan Berger, Head of Investor Relations: +44 (0) 7595 567 502

Media enquiries:
Lesley McPherson, Director of Communications: +44 (0) 7725 903 270

David Masters, Lansons: +44 (0) 7825 427 514
Tony Langham, Lansons: +44 (0) 7979 692 287

About The Co-operative Bank
The Co-operative Bank plc provides a full range of banking products and services to almost 4 million retail and SME (Small and Medium Sized Enterprises) customers. The Bank is committed to values and ethics in line with the principles of the co-operative movement. The Co-operative Bank is authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority. The Co-operative Bank plc customers are protected by the Financial Services Compensation Scheme (FSCS) in the UK.

Note: all figures contained in this interim financial report are unaudited.