

The Co-operative Bank plc announces that the following document has today been submitted to the National Storage Mechanism and will shortly be available for inspection at [www.hemscott.com/nsm.do](http://www.hemscott.com/nsm.do).

- Interim Accounts 2014

A copy of the Interim Accounts 2014 and an investor presentation are available within the Investor Relations section of our website [www.co-operativebank.co.uk/investorrelations](http://www.co-operativebank.co.uk/investorrelations)

This announcement also contains additional information for the purposes of compliance with the Disclosure and Transparency Rules, including a consolidated set of financial statements, principal risks and uncertainties, details of related party transactions and a responsibility statement. This information is extracted, in full unedited text, from the Interim Accounts 2014 (the "**Interim Accounts**"). Reference to pages and numbers refer to page numbers and notes to the Interim Accounts.

Issued: Friday 22 August 2014

### **Co-operative Bank Interim Report and Accounts for the six months ended 30 June 2014**

#### **Summary:**

- Statutory loss before tax of £75.8 million
- Capital position of the Bank strengthened following additional Common Equity Tier 1 (CET1) capital raising of £400 million in May. 30 June CET1 ratio of 11.5%
- The number of permanent employees has been reduced by 13% in first half of 2014
- Our review of products and practices is continuing; however no new categories of conduct or legal risk have been provided for in the first half of 2014 with total charges, including PPI, down from £163.0 million in June 2013 to £38.6 million in June 2014
- Non-core customer assets reduced from £12.5 billion to £11.5 billion; year-end target 2014 of £11.0 billion; expect target to be met comfortably
- Focus now on continued implementation of the plan to reshape the Bank around our Retail and SME customers and on the deployment of excess liquidity through increased mortgage lending
- Credit impairment benefit of £86.7 million. The largest contributor to the write back of credit impairment provisions was in Non-core as a result of the successful restructuring of two significant relationships
- Over 73,000 customers and colleagues responded to the Bank's Ethical Policy Poll – the results will be published in the autumn
- Brand reinvestment work has commenced

#### **Chief Executive Niall Booker said:**

"Considering the scale of the challenge we faced a year ago we are encouraged by the progress made to ensure the stability of the Bank. By the measures of capital and liquidity the bank is considerably stronger than it was a year ago. We are ahead of schedule in the disposal of Non-core assets and have improved governance, particularly at Board level. However, the issues we continue to face in building a sustainable business are deep rooted and there remains much to be done.

Transforming the organisation into a viable and profitable business which generates capital in the long term still requires significant change - both operationally and culturally.

The Core Bank continues to remain stable. In the first half of the year more people switched into the Bank than in the second half of 2013. Although we have also seen an increase in the number of people switching out of the Bank, the net numbers remain small relative to our total number of current account customers whose continuing loyalty is deeply appreciated. Recent trends suggest this net outflow of retail customers has slowed.

We have begun re-engaging with customers and over 73,000 responded to our Ethical Policy Poll to renew and refresh the Bank's ground-breaking Ethical Policy, the outcome of which is due in the autumn. Over the second half of 2014, we are also planning to re-invest in the brand and its distinctiveness in the market as we continue to focus on restoring customers' confidence and trust."

#### **Key highlights & outlook:**

##### **Statutory loss before tax of £75.8 million after credit impairment benefit of £86.7 million to the income statement (1H 2013: loss of £844.6 million)**

- Total Bank net interest margin improved at 1.17% despite lower balances
- Loss before tax of £75.8 million includes reduced operating costs of £297.1million, project costs of £68.8 million, a write back of £86.7 million of impairments on loans and advances, conduct and legal provisions of £38.6 million, fair value amortisation of £41.2million and FSCS levy of £25.3 million
- Capital position of the Bank strengthened following additional Common Equity Tier 1 (CET1) capital raising of £400 million in May. 30 June CET1 ratio of 11.5%
- CET1 ratio is expected to be materially above previous guidance of c.10% (including the contribution from the Co-operative Group in December 2014)
- Write backs concentrated in Non-core, with the largest contribution from write backs being successful restructuring of two large relationships, followed by upward revisions to valuations for assets still held with a small contribution from a reduction in the collective provision
- Our review of products and processes is continuing; however no new categories of conduct or legal risk have been provided for in the first half of 2014 with total charges, including PPI, down from £163.0 million in June 2013 to £38.6 million in June 2014
- Starting in 2014 the FSCS levy (£25.3 million) is payable in the first half of the year where previously it had been expensed in the second half
- Cost reduction programme delivered in year savings of £24 million to 30 June

##### **Core business stable**

- Core retail and SME deposit balances broadly stable at £27.2 billion
- Core customers' assets reduced by 8.5% to £16.2 billion (FY 2013: £17.6 billion) as redemptions and maturities more than offset new mortgages written
- Core net interest income fell 6.6% to £220.9 million (1H 2013: £236.5 million)
- Core net interest margin slightly higher at 1.58% (1H 2013: 1.55%)

- The number of primary current accounts decreased modestly since year end; renewed marketing of switching offer and branding work underway to address this
- During the first half of the year the Bank had a net loss of 28,199 current accounts, which represents less than 2% of the opening stock of accounts.

#### **Non-core deleverage ahead of target**

- Reduction in Non-core customer assets from £12.5 billion to £11.5 billion
- Corresponding reduction in Non-core risk weighted assets from £8.6 billion to £8.0 billion
- Write-back of credit impairment provisions of £88.2 million. The largest contributor to the write backs in Non-core was increased value resulting from the restructuring of two major relationships, followed by upward revisions to valuations for assets still held with a small contribution from a reduction in the collective provision
- Net loans reducing to c.£11 billion by end 2014; expect target to be met comfortably

#### **Simplification of the business continues**

- Size of branch network reduced by a further 16% since year end (46 branches)
- A further 25 branches to be closed in the fourth quarter
- Permanent staff numbers (Full time equivalents) year on year have fallen by 21% to 5,860

#### **Focus for the second half on continued implementation of the plan to reshape the Bank around our Retail and SME customers**

- Over 73,000 customers and colleagues responded to the Bank's Ethical Policy Poll, more than in the prior consultation; results of the poll will be published in the autumn
- Introduced our first banking app which has been downloaded by 400,000 customers; investment in digital platform continues
- We continue to review our SME proposition and intend to implement the findings of that review over time
- Significant marketing initiatives planned for the second half to build franchise and drive revenue

#### **Certain terms**

The term the 'Bank' means The Co-operative Bank plc together with its consolidated subsidiaries.

In this report the abbreviations '£m' represent millions of pounds sterling.

Unless otherwise stated, the income statement analyses and compares the 6 months to 30 June 2014 to the corresponding 6 months of 2013. The balance sheet comprises the corresponding position as at 31 December 2013. 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 the Interim Financial Reports. These can be found mainly (but not exclusively) on the Detailed financial review pages.

#### **Restatement**

Furthermore, certain 2013 balance sheet items have been restated. For further information, see note 3 to the Bank financial statements.

#### **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 Recapitalisation Plan and the Bank's 4-5 year turnaround 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 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 in this Interim Financial Report, as well as the 2013 Annual Report and Accounts and the Risk Factors document and prospectus published as part of the 2014 capital raising, both of which are available on our website ([www.co-operativebank.co.uk](http://www.co-operativebank.co.uk)) 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.

## **Chairman's statement**

The management team is making good progress to put the Bank back on track.

Our capital position has been strengthened by an additional £1.9bn raised through the successful completion of the Liability Management Exercise (LME) last December and the additional capital raising in May this year. We are also greatly encouraged about our progress in reducing risk weighted assets, having reduced Non-core customer assets by £1bn in the first six months of the year. We can report that our CET1 ratio at the end of June 2014 stood at 11.5%.

Despite the uncertainty in this period, the Core bank has remained more stable than we could have expected. Whilst there has been some reduction in deposits and an increase in the number of current account customers switching away from the Bank following negative publicity and significant competitor activity, our customers have remained very loyal. We are extremely grateful to them for their support and the impressive response to our Values and Ethics Poll illustrates how important it is to them that they can again feel proud of banking with us.

My focus has been to renew the Board and the reform of the governance of the Bank. Sir Christopher Kelly's independent review detailed serious failings in this area and we have already made considerable progress on many of the issues he raised. The reshaping of the Board is well advanced and we have recruited some excellent independent Non-Executive Directors. Recently, we welcomed Laura Carstensen to chair the Board's Values and Ethics Committee established at the end of 2013. Laura's experience both as a Commissioner at the Equality and Human Rights Commission and as the former Deputy Chairman of the UK Competition Commission brings significant insight and scrutiny to this role. This is a vital appointment and marks an important step forward in the Bank's move to embed co-operative values and ethics in its governance. We have also recruited Maureen Laurie who has over 30 years of experience in senior HR roles, including for organisations such as the British Council, NYSE EURONEXT and Barclays, to chair the Remuneration Committee. Derek Weir, who has over 25 years of financial services experience holding a range of senior positions in corporate and commercial banking, joins the Board as an Independent Non-Executive Director and the first Shareholder Nominated Director. In addition, earlier this year, we also put out to tender our external audit services contract earlier this year resulting in the appointment of Ernst & Young LLP as the Bank's auditors at our Annual General Meeting.

I announced in May my intention to step down from the Bank during 2014 and I will leave the Board on 1 October 2014. Whilst the Board's search for my successor is underway, Dennis Holt, who joined the Board in February as the Senior Independent Director, will be interim Chairman. In Niall Booker our CEO, the Bank is in experienced hands and I am confident the management team will continue to strengthen the Bank for the benefit of all our stakeholders. I would like to take this opportunity to wish Niall and his team well as they drive forward the transformation required. Running a bank underpinned by co-operative values is more relevant today than it has ever been. Whilst executing the plan remains challenging, the progress we have made and continue to make should reassure customers that if they believe in those values and ethics The Co-operative Bank should remain their bank of choice.

Richard Pym  
Chairman

21 August 2014

## **CEO Interim statement**

In my first statement as Chief Executive of The Co-operative Bank a year ago I talked about the deep rooted issues facing the Bank. As our results show today, those issues will continue to impact performance for some time but a year on we have taken significant steps forward. We have strengthened our liquidity and capital, are ahead of schedule in the reduction of Non-core assets and have improved governance, particularly at Board level. I would like to thank colleagues for their continued commitment throughout this period.

We continue to work closely with the Co-operative Group with whom we are united by our brand and the many customers we share. Whilst the Co-operative Group remains our largest shareholder, the Bank now has a range of shareholders who are invested in the future of the business. Their support through the additional capital raising in May is an endorsement of the business plan, the brand and our Co-operative values and ethics which sit at the heart of the organisation. We believe our Ethical Policy should help us not only define the type of customers we lend to but also inform how we operate. Alongside fixing the fundamentals in the Bank, this is central to rebuilding our retail franchise and growing our assets in the future. This was reflected by over 73,000 customers and colleagues taking part in our poll in June to refresh our Ethical Policy and we are greatly encouraged by customers' willingness to engage and share their views.

Transforming the organisation into a viable and profitable business in the long term still requires significant change – both operationally and culturally. To deliver the change required we have continued to strengthen the management team. In addition, as outlined in the Chairman's statement, we have also reshaped the Board to improve the governance in the Bank. As announced earlier this year our Chairman Richard Pym will step down from his role in October and the Board is currently undertaking a full and rigorous process to appoint his successor. On behalf of the Board I would like to thank Richard for the Board transformation he has achieved. Our strengthened governance framework places us in a much better position to drive forward the business plan and face the challenges ahead. We are very grateful to him for the leadership he has provided during a time of considerable change at the Bank.

## **Performance review**

In the first half of 2014, the financial performance of the business, although still dominated by the issues that came to light during 2013, was considerably better than the same period last year. The statutory loss before taxation was £76 million compared to a loss of £845 million at half year 2013. The main reason for this change is significant reductions in the level of credit impairments from a charge of £496 million in the first half of 2013 to a credit of £87 million in the first half of 2014. Our review of products and practices is continuing; however no new categories of conduct or legal risk have been provided for in the first half of 2014 with total charges, including PPI, down from £163 million in June 2013 to £39 million in June 2014.

The performance also shows the early progress the Bank is beginning to make in the implementation of the business plan in a number of key areas, particularly in the management of Non-core assets. The speed of the disposal of Non-core assets and the reduction in risk weighted assets reflects the headway made by the dedicated team we set up to manage the run down and disposal of these assets together with the benefit of the favourable economic conditions. A significant contributor to the write back of credit impairment provisions in Non-core is write backs on sale of restructured assets. This is in addition to upward revisions to valuations for assets still held, where we have received credible offers at levels in excess of carrying values as a result of work undertaken to increase the capital value of these assets. Two connections in this category were restructured and account for around half

of the overall credit impairment write back. The faster than expected deleveraging of these assets has contributed to increased liquidity in the first half of the year as well as the improved CET1 ratio.

The performance of the Core Bank has undoubtedly been impacted by the continuing uncertainty the Bank has faced over the last 6 months. However, despite the negative publicity surrounding reviews into past failings and the need to raise additional capital, on a net basis our total current account customers have reduced by less than 2%. On the asset side we remain impacted by the actions we took in 2013 to slow asset growth in order to preserve liquidity. In addition, mortgage sales have been affected by the new mortgage market regulations which came into force earlier this year. Progress has been made on addressing the cost base in the Core Bank as we continue our work to reshape the Bank as a smaller and more agile organisation serving our individual and SME customers.

### **Strengthened capital position**

This time last year the immediate priority was on maintaining adequate liquidity and improving the capital position of the Bank. A total of over £1.9 billion equity share capital has been added over the last 12 months through the successful completion of the Liability Management Exercise (LME) in December 2013 together with the additional £400 million capital raising in May this year. Raising this amount of capital in a short timeframe is a major achievement and provides some headroom for the management team to implement the business plan.

As at 30 June 2014 the Bank's CET1 ratio stood at 11.5%, exceeding our previous guidance. This is driven by the write back of credit impairment provisions in Non-core, the speed and timing of the deleveraging of Non-core assets, and reduced losses on disposals. Previous guidance assumed a charge for pension deficit contributions, and some adverse RWA model changes, as well as timing differences on asset sales, which may still come to fruition in the second half of 2014 with a consequent impact on the balance sheet and therefore the capital ratio. It is currently not possible to quantify the exact amount of this; however, the impact on the capital position is expected to be less than previously guided.

### **Simplifying the business**

Now that this additional capital has been secured, the management team has turned its attention to further simplifying the business and reducing costs. In the retail business we have completed 46 branch closures in the first half of 2014, and will be closing further branches during the second half of the year. Cost reduction is underway though some of this has been offset by the need to incur additional expenditure in relation to necessary remediation of systems and processes. In the first half of the year the Bank's cost reduction programme has started to deliver savings through the reduction in the size of the Branch network, improving process efficiency and reducing 3rd party spend.

### **Run down and exit in Non-core**

In the first half of this year we have already reduced Non-core assets by £1 billion through a combination of formal trade sales, proactive rebanking of our Corporate clients and the natural run off of the Corporate book.

### **Performance of the Core Bank**

Whilst good progress has been made in the Non-core area, there is more work to do on our Core franchise. This is where the management team has been focused since the completion of the capital raising.

On my visits to branches and call centres I am always struck by the ongoing dedication of colleagues and I would like to convey my appreciation for the high levels of customer service they have maintained throughout the turmoil the Bank has faced.

The Core Bank continues to remain more stable than we might have expected given the ongoing uncertainty. Our current account switching data for the first half of 2014 as anticipated, and as noted in our capital raise circular, saw an increase in the number of customers switching out of the Bank. While this is disappointing the numbers remain small relative to our total number of current account customers whose continuing loyalty to the Bank is deeply appreciated. There has been some managed reduction in deposits with Core Retail deposit balances at £27.2 billion at the end of June 2014. Recent trends suggest the net outflow of retail customers has slowed and, having successfully restored the capital position of the Bank, our attention is on rebuilding customers' trust.

Progress has been made on addressing the cost base in the Core Bank with direct costs reduced by 10% in the first half of 2014 against the first half of 2013. Core Retail net interest income is relatively stable at £201.5 million.

Values and ethics remain a key reason for customers to bank with us and the Bank has recently been able to re-engage customers and seek their opinions through our poll to renew and revise our Ethical Policy. In addition, we launched a new switching offer at the beginning of the year. We have seen some growth since we re-entered the intermediary mortgage market, but continue to maintain tight control over our lending standards given the current state of the housing market, especially in London and the South East. We continue to review our SME proposition and intend to implement the findings of that review over time.

### **Transforming the Bank**

At year end I talked about simplifying our product range for both Retail and SME customers, strengthening our IT platform and investing in our digital capabilities to make it easier and more convenient for our customers to do business with us.

There have been over 400,000 mobile banking apps downloaded. Looking ahead, we have committed in the region of £500 million over the next three years to achieve the changes necessary in our systems and processes and have now begun our investment programme. This is a major task and there are significant execution risks around the scale of the transformation required but it is essential to the future of the Bank.

Progress has been made on the remediation of day to day regulatory issues, systems and processes but there is still significant work to be done. The process of separating the Bank from the Co-operative Group is also ongoing. Given the long history between the organisations, the separation issues are complicated but we are continuing to make progress and to work constructively with the Co-operative Group to achieve mutually beneficial outcomes.

### **Values and ethics**

Our ethical policy and broader values both define and differentiate us. Our ownership structure has changed but I can reassure customers that values and ethics remain at the heart of our bank as we rebuild.

At the time of the LME we embedded the co-operative values and ethics into our Articles of Association for the first time. We have also established a Board Committee to ensure our adherence to those standards and appointed a new independent Chair of that committee, Laura Carstensen. In June we launched our values and ethics poll designed to refresh our ethical policy and our customers have readily engaged in this process with over 73,000 taking part. We will be going back to our customers with a renewed ethical policy in the autumn.

## **Outlook**

There is still considerable work ahead of us as we undertake our 4-5 year Turnaround Plan but we are encouraged by the progress made in some key areas. This now allows us to push forward with simplifying the business, increasing revenue streams, reducing costs and investing in the technology to service customers in a way that suits them best. It also means we have begun to re-engage customers on what matters to them and we are re-investing in the brand and in its distinctiveness in the financial landscape. Our capital position is better than originally forecast but it is important to recognise we still need to ensure our capital base can meet the challenges ahead in terms of potential pension deficits, asset disposals, forthcoming stress tests and the outcome of regulatory reviews.

Following the capital raising in May, the Board has formed a committee to consider the feasibility and timing of an IPO and this is expected to meet for the first time in September and quarterly thereafter. The committee will take into account internal factors such as progress made in the Turnaround Plan, the ability of management to undertake an IPO and maintain its focus on improving the Core Bank's performance and the required robustness of systems and processes in financial reporting. In addition it will consider external factors such as the strength of the market, macroeconomic and political risks, the viability and relative merits of alternative strategic options and the views of the stakeholders, including the Bank's regulators and shareholders. The PRA has indicated it would be concerned if an IPO were to distract focus from the primary goal of delivering the Bank's Turnaround Plan and the Board from providing effective oversight of, and direction to, the business. It is logistically unlikely that an IPO could be executed before the end of 2014. Sir Christopher Kelly's independent review detailed wide-ranging failings in the Bank. The Board recently reviewed the changes made in the Bank against the points raised in the review. It was noted that considerable progress had been made in governance and provisioning policy management and the journey has begun on embedding a revised risk management framework. IT sustainability, day to day systems and processes and cultural changes however remain work in progress. Creating the right culture across the organisation is key to the future performance of the business. Our service ethic and empathy are real strengths but we must combine this with greater accountability, speed and ability to execute. In addition, ongoing external factors such as Government and regulatory reviews could negatively impact our progress in the months ahead.

Against this, we believe The Co-operative Bank has a valuable role to play in providing customers with a different choice in the market set apart as it is by the values and ethics that remain a key reason why customers choose to bank with us. As we head back to our roots focusing on our retail and SME customers, we are determined to restore confidence by ensuring those values and ethics act as the guiding principles by which we serve our customers day to day.

## **Capital**

- £400m (pre costs) additional CET1 raised in May.
- £150m capital commitment from the Co-operative Banking Group received.
- Total assets reduced by £2.3bn since December 2013.
- CET1 ratio 11.5% at June 2014 (7.2%<sup>1</sup> at December 2013), however the Bank remains below Individual Capital Guidance (ICG).

<sup>1</sup>Following the restatement discussed in note 3 CET1 ratio would have been 7.3% as at 31 December 2013. This restatement will be part of the regulatory capital calculation only once formally audited

## **Liquidity**

- Liquidity has increased in the period with an increase in primary liquidity of £624.1m and secondary liquidity of £265.5m.

## **Business Performance**

- Statutory loss before tax of £76m (June 2013: £845m loss) represents a significant improvement over 2013.
- Credit impairment £87m benefit to the income statement (June 2013: £496m charge<sup>2</sup>) reflecting management action taken to restructure client facilities including rebanking of customers together with macroeconomic improvements leading to improved collateral values.
- Review of products and practices is ongoing, however no new categories of conduct or legal risk have been provided for during the period.
- Non-core customer assets reduced by £990m since December 2013, in line with deleveraging strategy.
- Overall Core Bank customer franchise remained stable and Retail customer assets reduced by £1.5bn.
- Total assets reduced by £2.3bn since December 2013.

<sup>2</sup> The £496m credit impairment charge for the first half of 2013 includes £4m in relation to a customer fraud provision

## **Brand**

- Values and Ethics poll completed with over 73,000 customers and colleagues taking part.
- Brand relaunch work commenced.

## **Detailed Financial Review**

### **Capital**

The Basel III capital framework came into effect from 1 January 2014 and within the European Union this has been implemented by a new Capital Requirements Directive (CRD IV). Under Basel III a Leverage Ratio has been introduced which is a simpler measure of Bank capital levels and is based on the amount of good quality capital (Tier 1) compared to the overall balance sheet of the Bank.

During the first half of 2014, the Bank has made good progress toward improving the capital position and reducing the overall risk profile of the Bank. Completion of the £400m capital raising, together with the planned £150m injection from the Co-operative Banking Group and ongoing deleveraging, has resulted in a significant improvement in the capital position of the Bank.

	As at June 2014	As at December 2013	Change
<b>Capital ratios</b>			
Common Equity Tier 1 ratio	11.5%	7.2%	4.3%
Total capital	13.4%	9.0%	4.4%
Risk weighted assets (£bn)	13.9	15.1	(1.2)
Leverage ratio	3.7%	2.4%	1.3%

The £400m additional capital raising in May and the Co-operative Banking Group CET1 injections of £50m in January and £100m in June were the primary factors in the Bank's CET1 position increasing by £0.5bn to £1.6bn between December 2013 and June 2014. A further CET1 injection of £163m from the Co-operative Banking Group is due to be provided before the end of 2014. The increase in CET1 has resulted in the Bank's fully-loaded CRD IV CET1 ratio increasing by 4.3%, from 7.2% to 11.5%.

Risk weighted assets have decreased by £1.2bn since the year end. Non-core assets have been actively reduced and this is reflected in the £0.6bn reduction in Non-core risk weighted assets.

Leverage ratio is 3.7%, an increase of 1.3% since the 2013 year end. This is now above the proposed 3.0% regulatory minimum, due to be implemented in 2018.

The Bank is not currently compliant with its Individual Capital Guidance (ICG), being the PRA's statement as to the regulatory capital it expects the Bank to hold, although the Bank does meet its Pillar 1 capital requirements.

The capital plan, which has been shared with the PRA, forecasts that the Bank will meet the 7% CET1 ratio throughout the planning period. The capital plan anticipates sustainably meeting ICG by the latter part of the planning period, however full compliance with its current Capital Planning Buffer (CPB) is not anticipated during the planning period.

## 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 continues to be to:

- Reduce the holding of investment grade bonds not eligible for inclusion in the liquid asset buffer (LAB). This has maintained the cash held at central banks. It has also reduced the reliance on short dated secured financing to fund such assets and in turn reduced the amount of Treasury assets encumbered by the Bank;
- Increase secondary liquidity by further increasing the availability of mortgage collateral for funding; and
- Maintain ratings of secured funding programmes by the implementation of rating agency compliant back-up servicing arrangements to help ensure market access.

### Credit rating

In 2013, Fitch and Moody's downgraded the Bank by several notches. In April 2014, Moody's further downgraded the Bank to Caa2 from Caa1. The current ratings are:

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

The credit rating downgrades have:

- led to 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;
- negatively impacted the Bank's ability to access short term unsecured wholesale funding; and
- increased the Bank's collateral requirements within some clearing systems.

### Liquidity portfolio

The Bank's liquidity resources as at 30 June 2014 were £12.1bn compared to £11.2bn as at 31 December 2013. The table below analyses the Bank's liquidity portfolio by product and by liquidity value. Primary liquidity consists of liquid assets that are eligible under BIPRU 12.7 (LAB) and secondary liquidity consists of all other liquid assets (including self-issued retained securitisations and whole loans).

Liquidity has increased over the period with an increase in primary liquidity of £624.1m and secondary liquidity of £265.5m.

	June 2014 £m	December 2013 £m	Change £m
Operational balances with Central Banks	5,804.9	5,076.3	728.6
Gilts	974.2	789.5	184.7
Central government and multilateral development bank bonds	823.0	1,112.2	(289.2)

Total primary liquidity	7,602.1	6,978.0	624.1
Total secondary liquidity	4,480.9	4,215.4	265.5
Total liquidity	12,083.0	11,193.4	889.6

#### Retail and commercial funding

The majority of the Bank's funding comes from retail and commercial accounts. As at 30 June 2014, customer deposits were £31.5bn compared to £33.0bn as at 31 December 2013.

Retail deposits reduced over the period by c. £0.7bn.

The total amount of the Bank's corporate deposits has reduced by c.£1.0bn over the first half of the year. This was due to term deposits maturing which had been placed before last year's credit rating downgrades.

	June 2014 £m	December 2013 £m	Change £m
Current accounts:			
Retail	3,361.1	3,378.1	(17.0)
Corporate	2,181.6	2,298.9	(117.3)
Total current accounts	5,542.7	5,677.0	(134.3)
Instant access savings accounts			
Retail	7,498.7	8,097.2	(598.5)
Corporate	583.9	666.2	(82.3)
Total instant access saving accounts	8,082.6	8,763.4	(680.8)
Term deposits and bonds			
Retail	9,642.0	9,879.5	(237.5)
Corporate	534.1	1,344.9	(810.8)
Total term deposits and bonds	10,176.1	11,224.4	(1,048.3)
Individual savings accounts (ISA):			
Retail – ISA Fixed	3,914.6	3,853.1	61.5
Retail – ISA Demand	2,519.2	2,455.2	64.0
Total ISA accounts	6,433.8	6,308.3	125.5
Other deposits	1,223.8	1,028.3	195.5
Total customer deposits	31,459.0	33,001.4	(1,542.4)

#### Wholesale funding

The Bank uses wholesale funding to supplement retail and corporate 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, bilateral facilities, and repurchase agreements.

In January, the Bank repaid a c£400m bilateral facility and in February, the Bank redeemed a €25m Medium Term Note (MTN). Notice has been given for the optional redemption of the Silk Road Finance Number Two securitisation in September 2014. This is referred to in more detail in note 20.

	June 2014 £m	December 2013 £m	Change £m
Preference shares, PSBs and subordinated debt	206.7	196.3	10.4
Secured funding	3,706.3	4,339.5	(633.2)
Repos	1,496.2	2,119.3	(623.1)
Market borrowing	61.5	56.6	4.9
MTNs	850.9	884.0	(33.1)
Total wholesale funding	6,321.6	7,595.7	(1,274.1)

	June 2014 £m	December 2013 £m	Change £m
Repayable in less than 1 month	678.5	2,010.3	(1,331.8)
Repayable between 1 and 3 months	1.0	67.8	(66.8)
Repayable between 3 and 12 months	1,232.4	157.2	1,075.2
Repayable between 1 and 5 years	996.7	1,800.8	(804.1)
Repayable in more than 5 years	3,413.0	3,559.6	(146.6)

Total	6,321.6	7,595.7	(1,274.1)
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The table does not include the Funding for Lending Scheme. The Bank accessed the Funding for Lending Scheme in the first half of 2013, drawing £900m of UK treasury bills. The UK treasury bills remain available to the Bank until March 2017.

Figures are based on nominal values and accrued interest as at 30 June 2014 and 31 December 2013.

## 2014 Financial Performance

### Total Bank financial performance

The financial results for the first half of 2014 reflect initial progress in the Bank's Turnaround Plan with a statutory loss before taxation of £75.8m (H1 2013: £844.6m loss <sup>1</sup>) representing a significant improvement on the first half of 2013. The main factors impacting on the overall Bank performance are credit impairment stabilisation and a steady operating expenditure base. Our review of products and practices is continuing, however no new categories of conduct and legal risk have been provided for in the first half of 2014.

The Bank is continuing to successfully implement its Non-core asset deleverage strategy with customer assets reducing by £989.7m since December 2013 to £11.5bn. Overall, the Bank's balance sheet has contracted by £2.3bn since December 2013 mainly due to a reduction in customer assets. As well as the Non-core strategy, Retail mortgage lending has been impacted by the Mortgage Market Review (MMR) and increased redemptions. There remain a number of challenges ahead, including a continuing need to control and reduce the cost base, generate additional Core Bank income and complete the separation from the Co-operative Group.

	June 2014	June 2013	Change
	£m	£m	£m
Retail contribution <sup>a</sup>	177.7	156.4	21.3
BaCB contribution <sup>a</sup>	20.8	30.1	(9.3)
Treasury/other contribution <sup>a</sup>	(31.9)	17.7	(49.6)
Core contribution profit <sup>a</sup>	166.6	204.2	(37.6)
Operations and central costs <sup>b</sup>	(174.5)	(169.2)	(5.3)
Project costs	(60.0)	(45.2)	(14.8)
Core operating loss	(67.9)	(10.2)	(57.7)
Non-core operating result <sup>b</sup>	97.3	(490.4)	587.7
<b>Bank operating result</b>	<b>29.4</b>	<b>(500.6)</b>	<b>530.0</b>

<sup>a</sup> The Bank manages segmental analysis on a contribution basis. Contribution excludes operations and centralised costs and project costs. Comparative numbers have been restated for H1 2013 on a like for like basis.

<sup>b</sup> Operations and central costs are not allocated across the business segments within Core and Non-core. £9.8m is attributable to Non-core.

The Core business generated an operating loss of £67.9m (H1 2013: £10.2m loss) the variance of £57.7m is driven by Treasury/other contribution losses of £31.9m (H1 2013: £17.7m profit)<sup>2</sup> as a result of holding higher liquidity as well as a different asset quality mix of liquidity levels, and Retail contribution has improved by £21.3m on 2013 with lower income being more than offset by improving credit impairment and reduced costs.

The Non-core business, targeted for rundown and exit as part of the Bank's strategy, generated an operating result of £97.3m (H1 2013: £490.4m loss) benefiting significantly from improving credit conditions and management actions which allowed releases of credit impairment provisions.

The Bank's Net Interest Margin (NIM) improved to 1.17% (H1 2013: 1.02%) with the Core bank NIM at 1.58% up on 2013 by 3bps. Retail NIM improved year on year (H1 2014: 2.51%, H1 2013: 2.30%). This increase is driven by reduced pricing on liability products and increased mortgage redemption income offset by a higher liquidity recharge.

The margin increases in the Retail business have been offset by reductions in NIM in both BaCB (driven by a reduction of liability balances) and in the Treasury portfolio (driven by excess liquidity).

<sup>1</sup> H1 2013 includes: a restatement of £24.8m additional expense relating to FSCS Levy, (£(8.0)m interest income and £(0.4)m non-interest income), relating to changes to hedge accounting methodology. (See note 3).

<sup>2</sup> H1 2013 includes profits from sale of assets of £40.4m (£35.0m non-interest income and £5.4m interest income).

	June 2014	June 2013	Change
	£m	£m	£m
Operating income	308.5	347.4	(38.9)
Operating expenditure <sup>c</sup>	(297.0)	(307.2)	10.2
Project costs <sup>d</sup>	(68.8)	(48.9)	(19.9)
Impairment gains / (losses) on loans and advances <sup>e</sup>	86.7	(491.9)	578.6
Operating result	29.4	(500.6)	530.0
FSCS levy (Bank)	(25.3)	(24.7)	(0.6)
Share of post tax (losses) / profits from joint ventures	(0.1)	0.3	(0.4)
Intangible asset impairment	-	(148.4)	148.4
Conduct and legal risk <sup>3</sup>	(38.6)	(163.0)	124.4
Fair value amortisation	(41.2)	(8.2)	(33.0)
(Loss)/profit before taxation	(75.8)	(844.6)	768.8

In 2013 we showed operating costs split between 'steady state' and 'strategic initiatives'. These classifications have now been amended as follows:

<sup>c</sup> Steady state operating costs have now been split into direct costs (by business segment) and operations and centralised costs. These are known collectively as operating expenditure at divisional level for Core, Non-core and Total Bank.

<sup>d</sup> Strategic initiatives are now classified as 'Project costs'. Project costs also include 'Non-operating costs' reported in 2013 below operating result.



<sup>e</sup> H1 2013 includes £4.1m reclassification to direct operating costs related to losses associated with fraudulent customer activities that were identified during the period.

The numbers referenced and presented on these pages are on a management accounts basis. A reconciliation of these numbers to the statutory accounts basis is provided in the segmental information in note 4.

Balance sheet contraction and lower non-interest income has led to income falling by £38.9m to £308.5m. This, coupled with stable operating costs as set out below, has led to an increase in the cost income ratio to 96.3% (H1 2013: 88.4%)<sup>4</sup>.

<sup>3</sup> H1 2013 Conduct and legal risk excludes £3.7m redress costs relating to interest payments, which has been included within operating expenditure.

<sup>4</sup> H1 2013 Cost income ratio has been restated to 88.4% due to the inclusion of £4.1m of fraud, previously classified within impairment and the £8.4m charge to income relating to changes to hedge accounting methodology.

### Operating costs

	June 2014	June 2013	Change
	£m	£m	£m
Core Bank direct costs	(98.5)	(110.0)	11.5
Non-core direct costs	(14.2)	(8.6)	(5.6)
Operations and central costs	(184.3)	(188.6)	4.3
<b>Total operating costs</b>	<b>(297.0)</b>	<b>(307.2)</b>	<b>10.2</b>

The costs above reflect the operating costs of the Bank and exclude all project expenditure. Costs for the first half of 2014 are £297.0m, a reduction of £10.2m (3%) on the same period in 2013.

Within the Core Bank, direct costs for H1 2014 are £98.5m (H1 2013: £110.0m), a year on year reduction of £11.5m (10%). This is mainly as a result of cost saving initiatives including the reduction of branches from 294 to 248 resulting in a saving of £3m in H1 2014 (£6.8m annualised). Other initiatives include reduced third party contract spend and process improvements to deliver headcount reductions.

Non-core direct costs are £14.2m (H1 2013: £8.6m). This year on year increase of £5.6m (65%) reflects the cost of managing the accelerated deleveraging activity.

Operations and central costs are £184.3m (H1 2013: £188.6m), a year on year reduction of £4.3m (2%). Process improvements in the first half of the year driven by IT and Operations have resulted in reduced headcount and third party spend delivering cost reductions of c. £15m (£34m annualised). (H1 2013 also included a one-off provision for ATM rates not included in expenses for H1 2014 of £14m.) These cost reductions are offset by c. £10m of incremental costs arising as a result of the separation of the Bank from the Co-operative Group. This comprises one-off third party contract separation costs and incremental VAT (predominantly associated with delays in separation) and further ongoing costs arising from separation dis-synergies. Incremental costs have also arisen as a result of colleague bonuses, the impact of recognising the Britannia pension scheme on the Bank's balance sheet and the incremental cost of implementing increased banking industry regulation.

	June 2014	June 2013	Change
	£m	£m	£m
Staff Costs	(127.8)	(123.8)	(4.0)
Non Staff Costs	(169.2)	(183.4)	14.2
<b>Total operating costs</b>	<b>(297.0)</b>	<b>(307.2)</b>	<b>10.2</b>

Staff costs have increased year on year by £4m. Staff numbers (full time equivalents) year on year have fallen by 21% to 5,860 delivering a 10% sustainable reduction in salary costs in H1 2014. This has been offset by a short to medium term increase in contractor costs (primarily specialist resource required to support the Bank's transition), a provision for colleague bonuses as part of the Bank's staff retention initiatives and the impact of recognising the unfunded Britannia pension scheme in the accounts of the Bank.

Non staff costs have fallen by £14.2m year on year. The main drivers for the cost reduction relate to a one-off ATM rates provision included in H1 2013 of £14m and the financial impact of cost reduction initiatives as outlined above. These have been offset by additional costs arising from separation and fees associated with the cost of managing the accelerated deleveraging activity.

### Project costs

	June 2014	June 2013	Change
	£m	£m	£m
Operational projects	(20.3)	(12.6)	(7.7)
Remediation, integration & resiliency projects	(20.9)	(5.0)	(15.9)
Strategic projects and exceptional items	(27.6)	(31.3)	3.7
<b>Total project expenditure</b>	<b>(68.8)</b>	<b>(48.9)</b>	<b>(19.9)</b>

Non-capital project costs for the half year are £68.8m, an increase of £19.9m on 2013. Although total project investment spend (revenue and capital) is in line with 2013, a focus on remediation and regulatory projects resulted in a higher charge to revenue and a reduced level of capitalisation in H1 2014. Capital spend is anticipated to increase in H2 2014 and continue in future years of the Plan as strategic projects are initiated and existing projects progress.

Operational project expenditure is necessary to ensure the regulatory and mandatory requirements of the Bank are met. Increased expenditure in H1 2014 of £7.7m is mainly due to further investment in the Regulatory Reporting Programme to comply with the Basel III reporting regulations and on Mortgage Business Review to deliver a solution to meet the MMR and Mortgages Conduct of Business legislation.

Expenditure on remediating, integrating and improving resiliency has increased in H1 2014 as work on the IT Remediation Programme, which was initiated in H2 2013, continues. A further £6.8m has been incurred in H1 2014 in separating the Bank from the Co-operative Group, its former parent.

Strategic projects predominantly cover spend on the delivery of a new platform to provide enhanced digital capabilities for online and mobile banking. Additional strategic investment in H1 2014 included redundancy costs of £7.4m and £6.9m relating to the impairment of branch related infrastructure as a result of new technology in the branches. Phase 1 of the Branch Transformation Programme was provided for in H2 2013 and no incremental costs have therefore been incurred in H1 2014. Further branch transformation costs will be incurred in H2 for additional branch closures.

### Impairment losses

All segments of the business have lower impairment losses as a result of improved credit conditions. In particular a Non-core impairment of £88.2m benefit has been recognised in the first half of the year (H1 2013: £469.1m charge), due to the new team focusing on the distressed asset work-out and turnaround capability and, as a result of both this specialist team and the improving economic environment, assets have been disposed of at favourable prices resulting in write-back of previously recognised impairment provisions. In addition, the Bank has booked upwards revisions to valuations for assets still held, where credible offers at levels in excess of carrying values as a result of work undertaken. Two connections in this category which were restructured in the latter part of the period account for around half of the overall credit impairment write back.

At 30 June 2014, the year on year improvement in the impairment losses is also reflected in the Bank's balance sheet position with provision coverage reduced to 28.4% (H1 2013: 33.3%) and impaired loans as a percentage of assets at 11.5% (H1 2013: 12.3%).

### Conduct and legal risk

Whilst the review of products and practices is continuing, no new categories of conduct risk have been provided for in 2014.

The total conduct and legal risk charge for the period of £38.6m (H1 2013: £163.0m) includes £29m relating to previously identified breaches of the technical requirements of the Consumer Credit Act (CCA) within the unsecured book, a further £5m increase for Payment Protection Insurance (PPI) and an additional net £4.6m for mortgage related conduct risk (see note 13).

The additional PPI provision reflects the latest trends and expectations of complaint volumes, uphold rates, payout data and costs. The CCA provision includes £16m for the first half of 2014 of interest foregone per prior guidance plus an additional amount of £13m due to revision of previous estimates from 2013. A review of methodology led to the additional mortgage related provision due to the availability of better information as work continues through the remediation and customer redress process which is expected to be completed in 2015.

### Total Bank balance sheet

#### Total assets

	June 2014	December 2013	Change
	£m	£m	£m
Cash and balances at central banks	6,103.7	5,418.8	684.9
Loans and advances to banks	1,644.6	1,594.4	50.2
Loans and advances to customers	27,836.4	30,322.2	(2,485.8)
Investment securities	4,197.9	4,499.4	(301.5)
Other assets <sup>f</sup>	1,294.0	1,562.5	(268.5)
<b>Total assets</b>	<b>41,076.6</b>	<b>43,397.3</b>	<b>(2,320.7)</b>

<sup>f</sup> Restatement of 2013 Other assets by £1.2m. Comprising of fair value on hedge risk accounting change £(1.3)m and deferred tax £2.5m. (See note 3).

Loans and advances to customers have reduced, primarily in the Core Retail business due to lower mortgage originations which have been affected by the on-going impact of the MMR (increased requirements for banks to ensure the product is suitable for the customer) and mortgage redemptions. In addition, the Non-core asset deleverage strategy has reduced the Bank's balance sheet by £1bn.

#### Total liabilities

	June 2014	December 2013	Change
	£m	£m	£m
Deposits by banks	2,136.3	2,757.5	(621.2)
Customer accounts	31,459.0	33,001.4	(1,542.4)
Debt securities and derivatives <sup>g</sup>	4,361.9	4,746.2	(384.3)
Other borrowed funds	196.3	196.3	0.0
Other liabilities <sup>h</sup>	807.9	903.4	(95.5)
<b>Total liabilities</b>	<b>38,961.4</b>	<b>41,604.8</b>	<b>(2,643.4)</b>

<sup>g</sup> Restatement of 2013 Debt securities and derivatives by £12.3m due to change in fair value on hedge risk accounting. (See note 3).

<sup>h</sup> Restatement of 2013 Other liabilities by £(26.3)m due to change in FSCS levy accounting. (See note 3).

Customer liabilities have been adversely impacted by past negative media coverage of the Bank and the Co-operative Group with whom we share our brand. To counter this, the Bank has invested in a wide-ranging customer driven review into values and ethics to build upon its ethical stance and consolidate brand loyalty. The Bank has commenced work on a marketing campaign which builds on the Bank's brand positioning.

### Retail

	June 2014	June 2013	Change
	£m	£m	£m

Net interest income	201.5	203.5	(2.0)
Non-interest income	55.9	65.0	(9.1)
Net income	257.4	268.5	(11.1)
Direct costs <sup>1</sup>	(78.4)	(90.4)	12.0
Impairment gains / (losses) on loans and advances <sup>1</sup>	(1.3)	(21.7)	20.4
Contribution result	177.7	156.4	21.3
Net interest margin (annualised)	2.51%	2.30%	0.21%

	June 2014	December 2013	Change
	£m	£m	£m
Customer assets	15,335.5	16,790.9	(1,455.4)
Customer liabilities	27,249.1	27,899.3	(650.2)

<sup>1</sup> H1 2013 includes £3.2m reclassification to direct costs from impairment on loans and advances, related to losses associated with fraudulent customer activities that were identified during the period.

The Retail contribution result for 2014 is £177.7m (H1 2013: £156.4m). This performance reflects lower non-interest income, improved costs and lower impairments.

Net interest margin has increased year on year to 2.51% (increase of 0.21%). This increase is driven by maintaining net interest income levels relative to reducing customer balances. Despite lower customer receipts, the Retail Bank has benefited from lowering customer rates on long term savings products in line with the market. Additional income from mortgage redemptions has been offset by higher liquidity recharging as a result of a change in allocation policy. The Retail Bank has seen interest income reductions resulting from balance outflows due to negative publicity and mortgage pricing actions taken in 2013. In addition, mortgage sales have been affected by the new mortgage market regulations which came into force earlier this year.

However, despite the adverse publicity of late 2013 and early 2014, and focused marketing action from competitors resulting in some loss of customers, the overall customer base remains loyal. During the first half of the year the Bank had a net loss of 28,199 current accounts, which represents less than 2.0% of the opening stock of accounts. Alongside recommencement of Retail mortgage lending activities, recent trends indicate that the net outflow of retail customers has slowed. Furthermore, income reductions have been offset by the favourable macro impairment climate, mainly driven by increases in the house price index this year.

#### Business and Commercial Banking (BaCB)

	June 2014	June 2013	Change
	£m	£m	£m
Net interest income	23.0	34.4	(11.4)
Non-interest income	7.9	7.7	0.2
Net income	30.9	42.1	(11.2)
Direct costs <sup>1</sup>	(8.7)	(11.5)	2.8
Impairment losses on loans and advances <sup>1</sup>	(1.4)	(0.5)	(0.9)
Contribution result	20.8	30.1	(9.3)
Net interest margin (annualised)	5.67%	7.18%	(1.51%)

	June 2014	December 2013	Change
	£m	£m	£m
Customer assets	778.8	844.9	(66.1)
Customer liabilities	2,594.6	3,479.0	(884.4)

<sup>1</sup>H1 2013 includes £0.9m reclassification to direct costs from impairment on loans and advances, related to losses associated with fraudulent customer activities that were identified during the period.

Similarly, BaCB has experienced contraction in its balance sheet as a result of difficult trading conditions. In particular, in line with expectations, customer deposits have reduced by £884.4m in the first 6 months, as annual fixed term deposits have not been renewed by ratings sensitive depositors.

Total net interest income has fallen driven by the reduction in the liability balances, and as customer assets are significantly lower than the liability balances, the net interest margin has materially reduced.

#### Treasury/Other

	June 2014	June 2013	Change
	£m	£m	£m
Net interest income	(3.6)	(1.4)	(2.2)
Non-interest income	(18.1)	27.8	(45.9)
Net income	(21.7)	26.4	(48.1)
Direct costs	(11.4)	(8.1)	(3.3)
Impairment gains / (losses) on loans and advances	1.2	(0.6)	1.8
Contribution result	(31.9)	17.7	(49.6)
Net interest margin (annualised)	(0.06)%	0.06%	(0.12)%

	June 2014	December 2013	Change
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	£m	£m	£m
Assets	11,387.7	10,932.4	455.3
Liabilities	6,886.5	8,040.4	(1,153.9)

The reduction in net interest income has been driven by two factors:

- The change in asset and liability mix of the Treasury balance sheet; and
- A revised policy on distributing the cost of holding liquidity.

Treasury continued to reduce assets not eligible for the liquid asset buffer, resulting in an asset portfolio consisting materially of highly liquid gilts, multilateral development banks and cash. The downgrade of the Bank's credit ratings in 2013 to below investment grade led to a reduction in the Bank's rating sensitive deposits. These deposits had a relatively low cost of funding compared to non-rating sensitive deposits. There was also wholesale funding entered into with a higher cost of funding, which together with the rating sensitive deposit impact increased the average cost of funding of the Bank's liquidity portfolio. Furthermore, due to lower credit ratings, the Bank is required to maintain collateral postings within central payment systems. These assets typically consist of lower yielding government bonds and Treasury bills thereby further impacting net interest income.

The allocation policy for the cost of holding the Bank's liquid asset buffer (LAB) was changed at the start of 2014, resulting in Treasury absorbing the cost of holding any liquid assets above the liquidity risk appetite (LRA) amount directly attributable to products (as opposed to allocating out the entire LAB cost). The impact of this policy change in H1 2014 was a reduction in net interest income for Treasury of c.£11m as more of the cost was retained and not distributed to other business segments.

The Bank has reviewed its hedge accounting strategies in conjunction with its auditors and the interpretations applied to hedge accounting in accordance with IAS 39 (Financial Instruments: Recognition and Measurement) and best practice. Based on this review the Bank has amended its calculation of hedge ineffectiveness resulting from these models and retrospectively restated prior year results for the change in methodology (see note 3). This has decreased the net interest income by £3.4m (H1 2013: £(8.0)m) in the first 6 months of 2014. This does not affect the economic performance of the hedge.

Non-interest income has reduced significantly when compared to the first half of 2013 due to:

- Losses on the sale of non-liquid assets; and
- The hedge accounting adjustment loss on cross currency swaps.

During the first six months of 2013, profits from asset sales accounted for c.£35m of non-interest income whilst there was a loss of c.£4m on asset sale proceeds recorded in H1 2014.

The hedge accounting review (see note 3) has resulted in a loss of £6.4m (H1 2013: £0.4m loss) on cross currency micro hedging which has added to the reduction in non-interest income.

#### Non-core

	June 2014	December 2013	Change
	£m	£m	£m
Corporate CoAM	4,867.9	5,646.1	(778.2)
Optimum	7,117.4	7,326.1	(208.7)
Illius	156.0	162.2	(6.2)
Assets	12,141.3	13,134.4	(993.1)
Corporate CoAM	809.3	831.0	(21.7)
Optimum	-	-	-
Illius	-	-	-
Liabilities	809.3	831.0	(21.7)
Customer assets	11,483.7	12,473.4	(989.7)
Customer liabilities	809.3	831.0	(21.7)

	June 2014	June 2013	Change
	£m	£m	£m
Net interest income	27.0	4.5	22.5
Non-interest income	14.9	5.9	9.0
Net income	41.9	10.4	31.5
Operating expenditure	(24.0)	(28.0)	4.0
Project costs	(8.8)	(3.7)	(5.1)
Impairment gains / (losses) on loans and advances	88.2	(469.1)	557.3
Operating result	97.3	(490.4)	587.7

In line with its strategy, the Bank is actively reducing its Non-core assets. The Bank has been able to achieve favourable disposal proceeds due to proactive restructuring of assets and improved credit conditions and has benefited from the establishment of a dedicated team focused on the deleverage of the book. The team has special skills in managing Non-core/ defaulted/ non-performing assets. Consequently, the Non-core operating result shows a profit in the first half of 2014 of £97.3m (H1 2013: £490.4m loss).

The Corporate portfolio contributions were £96.3m (H1 2013: £406.2m loss) driven by impairment credits, and the Optimum portfolio (a closed book of intermediary and acquired mortgage book assets) recorded a contribution of £26.1m (H1 2013: £41.6m loss).

The Illius business (a closed residential property portfolio) incurred a contribution loss of £6.5m (H1 2013: £19.5m loss). This favourable improvement on last year is mainly as a result of reduced fair value impacts to the asset portfolio H1 2014: £6.1m charge (H1 2013: £18.9m charge).

## **Balance sheet liabilities – Non-core**

Corporate liabilities have fallen in line with strategy as there is active management of customers to enable them to move into an ongoing relationship with another provider.

## **Balance sheet assets – Non-core**

The Corporate CoAM assets, net of provisions, have decreased by £0.8bn as at 30 June 2014 to £4.9bn through the deleveraging strategy. The closed Optimum portfolio has also reduced by £0.2bn as customers continue to pay down their mortgages.

## **Outlook**

The Bank is in the early stages of its Turnaround Plan and we have made good progress in delivering some aspects of the strategy particularly in Non-core deleveraging which is on track to deliver against its revised short to medium term targets. The additional capital raise in the first half of the year has provided a firmer foundation to deliver the Core Bank strategy of serving the needs of individuals and SMEs where the Bank has heritage and strong customer relationships. The management team continues to believe the Plan will deliver a sustainable improvement in performance over time.

We have seen improvements in the macroeconomic outlook, however the Bank continues to face both internal and external challenges in the effective execution of the objectives that underpin the strategy. The most significant of the risks and challenges the Bank faces are summarised in the Principal risks and uncertainties section of this Interim Financial Report.

## **Principal risks and uncertainties**

### ***Background to the significant risks and uncertainties faced by the Bank***

Significant elements of the uncertainty around the going concern status of the Bank were removed with the successful completion of the two capital raising exercises in December 2013 and May 2014, however, the Bank continues to face challenges in executing its Turnaround Plan. The Bank will need to simultaneously execute a number of complex and concurrent changes in an environment where adverse publicity regarding events and the Bank's difficulties (and the circumstances that led to those difficulties) may have damaged the Bank's brand and reputation. More details of the risks facing the Bank are set out in the risk factors which were set out in the offering circular in May 2014 for the recent capital raising which can be located on our website (<http://www.co-operativebank.co.uk/assets/pdf/bank/news/Risk-factors-May-2014.pdf>).

### ***External factors***

Many of these are similar to those other financial institutions may face, for example, deterioration in general economic conditions, instability of global financial markets and the management of credit risk, interest rate risk, currency risk and market risk and risks from regulatory change and an increasing regulatory enforcement and litigious environment.

In July 2014, the Competition and Markets Authority (CMA) announced a potential review into the operation of the current account and SME banking markets. Such enquiries tend to be time consuming and require management time and attention. It is currently not possible to ascertain whether the impact of such a review and any consequential structural changes or requirements for the industry as a whole would be positive for or harmful to the position of the Bank.

### ***Internal factors***

Outlined below is the most significant of those risks and uncertainties specific to the Bank and which could have a meaningful impact on the Bank's results of operations, financial conditions and prospects.

### ***Key strategic risks and uncertainties***

- The Bank's Turnaround Plan is in the early stages of implementation and has yet to be proven. A failure to successfully implement or a delay in implementing the Bank's strategy may adversely impact the Bank's business, operating results, financial condition and prospects, its regulatory capital position and its ability to comply with its regulatory capital requirements;
- The Bank does not have a track record in successfully executing large scale changes like those contemplated by its plan;
- The required improvement and re-engineering of the Bank's IT platform and operational process is significant in scale, complexity and cost. Any delays in, or failure by, the Bank to deliver the re-engineering of the Bank's IT platform may result in on-going risk of technology failure, significant additional investment costs, subject the Bank to further regulatory scrutiny and impact the Bank's ability to deliver its turnaround strategy;
- Along with the wider banking industry, the Bank must comply with multiple regulatory changes which may add complexity to an already difficult technology and prudential change programme;
- These regulatory initiatives may also have an impact on systems, processes and product design with potential compliance and investment costs;
- A new Chairman will need to be appointed and there are a number of recent appointments to the Board which need to be embedded. Despite progress on retention and recruitment, the Bank is dependent on its Directors, senior management team and skilled personnel and the loss of one or more Directors or members of senior management or the loss of or failure to recruit and retain skilled personnel may have an adverse effect on the Bank's business, operating results, financial condition and prospects and its ability to achieve its strategy;
- Implementation of significant cost reductions, branch closures, redundancies and reorientation of the Bank's distribution channels may not achieve the targeted cost savings. These cost savings may have a negative impact on the Bank's brand, customer service and levels of customer satisfaction and therefore income;

- The inability of the Bank to deleverage its Non-core assets in a controlled and capital efficient manner may have a negative impact on the Bank's business, operating results, financial condition and prospects, its regulatory capital position and its ability to comply with its regulatory capital requirements. Any greater than expected costs or delays in deleveraging the Non-core assets may divert funding from and adversely impact the growth of the Core business;
- The Non-core business has impairment risk, especially given the concentration of the Non-core corporate asset book;
- 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 caused by any serious loss of confidence by its depositors resulting in unusually high levels of withdrawals;
- The Bank's business is subject to inherent risks concerning liquidity, particularly if the availability of traditional sources of funding such as retail deposits becomes limited and/or becomes more expensive, and this may have an adverse effect on the Bank's business, profitability and ability to meet its liabilities as they fall due;
- The Bank may be required to hold more regulatory capital, or to take other steps to mitigate the risks identified, as part of the stress tests of capital adequacy, profitability and capital ratios that the Bank and seven other UK banks submitted in 2014 to the FCA and PRA for consideration by the fourth quarter of 2014;
- The Bank needs the ongoing forbearance of the PRA regarding its ICG deficit. The PRA has the discretion to revisit, change or withdraw that forbearance. If the Bank fails to meet its ICG, there is a risk that the PRA may exercise any of its wide-ranging powers over the Bank including imposing a resolution procedure on the Bank at any time;
- Additional non-CET1 capital is contemplated by the Bank's four to five year Turnaround Plan. Further additional equity and/or debt capital may be required, beyond that contemplated currently, because of increased capital requirements (applicable to the Bank or banks generally), actual costs and losses exceeding those estimated in the Bank's plan or if the Bank does not deliver on its plan as anticipated the Bank may be unable to raise any additional CET1 or other capital it may need on favourable terms, when needed, or at all;
- Future legislative and regulatory changes could impose operational restrictions on the Bank, increase the Bank's costs and/or capital requirements and/or otherwise materially adversely affect its business, operating results, financial condition and prospects;
- There is a risk that the Bank's ownership structure following the Liability Management Exercise and the Capital Raising may undermine the Bank's reputation as being more focused on values and ethics than its competitors. Such a reputation has been a competitive advantage for the Bank;
- The Bank will continue to rely on the Co-operative brand. Should, as a result of matters relating to the Co-operative Group, the Bank's brand, levels of customer satisfaction or the co-operative movement more generally be damaged, this would have a negative effect on the Bank's business, operating results, financial condition and prospects and negatively impact the ability of the Bank to achieve its stated strategy;
- The Co-operative Group could sell some or all of its ordinary shares in the Bank to an unknown third party; and
- In the event that the current process of consultation on changes to governance arrangements at the Co-operative Group or any adverse findings of any of the various enquiries and investigations underway which impact on the Co-operative Group, result in organisational disruption in operations or decision making at the Co-operative Group, the execution risks to the process of logistical separation could increase with an associated risk of increased costs and disruption for the Bank.

### ***Key operational risks and uncertainties***

In this section, by operational risks and uncertainties, we mean risks and uncertainties relating to the Bank's internal activities, systems and controls. The most significant operational risks and uncertainties faced by the Bank include:

- The Bank's underlying business and financial systems are dated and suffer from a lack of integration and investment since the Britannia merger in 2009; consequently many processes rely on significant manual intervention to cope with a poor systems infrastructure;
- The Bank has new external auditors who have yet to complete an audit of the Bank's accounts. This may result in a reassessment of current accounting practices and increased reputational risk;
- The Bank's systems of control have been weak and there have been failings by the Bank's business units in a number of areas in the past;
- Although the foundation of the Bank's more robust controls including the Bank's revised and updated Risk Management Framework (adopted in September 2013) have been laid, it will take time and significant work to embed across the Bank. Inadequate risk management processes could lead to exposures outside the Bank's risk appetite and unforeseen losses;
- Failure to adequately maintain corporate records or to adequately maintain and protect customer and employee information could have a material adverse effect on the Bank;
- Risk that the Bank's insurance cover may be inadequate, that it will be difficult for the Bank to obtain insurance and that those insurance policies which the Bank has in place might become void or voidable;
- The Bank currently depends on the Co-operative Group to provide a number of services including certain critical functions: IT, personnel, assets and to on-supply certain services, data and assets by third party suppliers. The Bank is operationally dependent on the Co-operative Group and has significant counterparty exposure to the Co-operative Group. Further deterioration or perceived deterioration in the soundness of the Co-operative Group may have a material adverse effect on the Bank's business, financial condition, operating results, reputation and prospects;
- A complex project to separate the Bank from the Co-operative Group is underway. Negotiations continue with the Co-operative Group in relation to the transfer of key assets used by the Bank, and arrangements for the provision of key functions and services to the Bank, including

IT. The separation project is complex and may be more costly than currently contemplated. Any new arrangements may be less favourable to the Bank than the existing arrangements;

- In total balances owed by the Co-operative Group to the Bank exceed amounts owed by any other single counterparty. These obligations are under continuous review, however the Board considers that impairment is not currently required; and
- The Bank does not have any documented right to occupy several of its principal establishments and places of business. The Bank's current occupation of some properties owned by the Co-operative Group is in breach of the terms of the lease for that property.

### **Key regulatory and conduct risks and uncertainties**

The Bank is under intense regulatory scrutiny and expects that environment to continue. The Bank is also the subject of multiple regulatory and other investigations and enquiries into events at the Bank and circumstances surrounding them. These are discussed and considered in detail in the 2013 Annual Report and Accounts.

- The Treasury Select Committee has been conducting an ongoing review which began in the second quarter of 2013 and has focused on numerous concerns surrounding the Bank. The Committee will publish a report of its findings, the timing of which is not known;
- The Treasury announced on 22 November 2013 that it would conduct an independent investigation into events at the Bank and the circumstances surrounding them from 2008, including the Verde transaction and Britannia acquisition. The investigation will include a review of the conduct of regulators and Government, but is not anticipated to commence until it is clear that it will not prejudice the outcome of the FCA and PRA enforcement investigations;
- The FCA announced on 6 January 2014 that it will be undertaking enforcement investigations into events at the Bank. The investigation will look at the decisions and events up to June 2013; and
- The PRA announced on 6 January 2014 that it is undertaking an enforcement investigation in relation to the Bank and as part of that investigation will consider the role of former senior managers.

Both FCA and PRA investigations are underway but still in the early stages and the Bank is co-operating fully.

Is it still too early to predict the outcome of each of these investigations with any degree of certainty. These investigations and inquiries are likely to result in:

- Significant expense which may include damages, fines and other penalties;
- Greater scrutiny and/or intervention from regulators, further regulatory action and/or litigation;
- Taking a significant amount of management time and resources away from management of the Bank's business including execution of the Bank's plan; and
- Further adverse publicity and reputational damage to the Bank, its brand and its ability to recruit and retain personnel and customers.

In addition, 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 regulator. Any change in the regulator's current approach, such as an extension of the period covered by the requirement for proactive contact with customers, could have a material impact.

The Bank is exposed to many forms of legal and regulatory risk, which may arise in a number of ways. As part of its strategy to identify and resolve outstanding liability issues, the Bank has started a structured risk-based assessment, of which the primary focus is the discovery and remediation of existing and new issues. These efforts have already resulted in the discovery of existing and new issues and the Bank is seeking to remediate such matters. However, while much work has been undertaken and progress has been made in identifying conduct issues, no assurance can be given that further issues will not be identified, or that the already identified issues may not require further provision.

The Bank has a large number of remediation projects to execute relating to conduct issues and failings from past business practices, some of which have continuing annual impacts until remediated and which require considerable management time and attention. Such projects are complex, timely and costly and depend on limited subject matter expertise within the Bank. Failing to implement the projects in a timely and efficient fashion could result in ongoing loss of income, increased costs of implementation, regulatory fine or censure and reputational damage.

In connection with the Bank's mortgage securitisation and covered bond transactions, the Bank makes various representations and warranties relating to the mortgage loans, including in relation to ownership, compliance with legislation and organisation procedures. If the representations and warranties are breached subject to any applicable materiality determination, or if any actual breaches identified are determined to be material the Bank may be required to repurchase the affected mortgage loans or in some circumstances pay compensation to the securitisation vehicle. There is a risk that a number of the underlying matters giving rise to conduct and legal provisions have given rise to breaches by such representations and warranties and that the process of remediation will require contact with the Trustee. Accordingly, there is a risk that the Bank may be required to pay compensation or to repurchase affected mortgage loans in amounts that may reduce the Bank's liquidity.

The Bank also faces both financial and reputational risk where legal or regulatory proceedings are brought against it or other financial institutions. Liability for damages may be incurred by third parties harmed by the conduct of the Bank's business.

The Bank continues to be exposed to the risks of non-compliance with the Consumer Credit Act. While the Bank has identified certain instances where its documentation or processes have not been fully compliant with the technical requirements, there may be other instances of non-compliance which have not yet been identified. Until remediation of the issues already identified is complete, the Bank remains in breach of the technical requirements of the Act and will be unable to enforce interest charges on the affected products.

Regulatory responsibility for the Consumer Credit Act passed to the FCA on 1 April 2014 and may lead to additional sanctions on banks in the event they are not fully compliant, or a requirement to pay additional redress to customers.

### ***Pensions risks and uncertainties***

The Bank participates in the following pensions schemes:

- The Pace Scheme, whose sponsoring employer is the Co-operative Group. The Bank is a participating employer in this scheme;
- The Britannia Scheme, whose sponsoring employer is CFS Management Services Limited; and three of the Bank subsidiaries are participating employers in this scheme. The Bank is a guarantor in respect of this scheme

### **PACE**

Currently, the Pace Scheme is accounted for by the Bank as a defined contribution plan. In the future, the Bank will account for the Pace Scheme as a defined benefit scheme. This is referred to in more detail in note 15 in the Bank Interim Financial Report.

There remains no contractual agreement determining how the deficit recovery contributions are funded by the participants. The Bank therefore has not recognised a liability in respect of any part of the existing deficit funding. The Bank is currently paying £0.5m per month in deficit funding.

The Bank's obligations to contribute to Pace would increase significantly if another large employer in Pace becomes insolvent while the Bank continues to participate. If the Bank seeks to address these risks by terminating its participation, the default position is that material liabilities in respect of the deficit in Pace will arise. The Co-operative Group and the Bank have agreed that at either party's request it may enter into good faith discussions to manage this by reaching agreement so that the liabilities properly attributable to the Bank (and an equivalent proportion of assets) would be transferred to a separate scheme, or a segregated section of Pace, on the Bank's exit but, as no arrangements have yet been agreed (and there is a risk that none can be agreed), there is uncertainty over the amount that the Bank will have to pay in the event that it exits Pace. The Pace Scheme is not sectionalised and operates on a 'last man standing' basis. In the event that other participating employers become insolvent and the full statutory debt is not recovered on insolvency, the Bank would become liable for the remaining liabilities.

Details of the latest triennial valuation of the Pace scheme are discussed in note 15.

### **Britannia**

In respect of the Britannia Scheme, the Bank will need to manage the liabilities that could arise on separation from the Co-operative Group; this will require the co-operation of the trustees of the Britannia Scheme, which may not be forthcoming.

Other pensions risks and uncertainties include the risk to the Bank's capital and funds from the Bank's exposure to scheme liabilities (to the extent liabilities are not met by scheme assets), risks inherent in the valuation of scheme liabilities and assets, risks regarding the split of liabilities between the Bank and other participating employers while the Bank continues to participate in Pace and on exit from Pace and, in respect of the Britannia Scheme, risks on separation from the Co-operative Group.

### **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

21 August 2014



## **The Co-operative Bank plc Board of Directors:**

Richard Pym	Chairman
Dennis Holt	Senior Independent Director
Niall Scott Kilgour Booker	Chief Executive Officer
Laura Martine Carstensen	Non-Executive Director
John Richard Coates	Non-Executive Director
Richard Graeme Barclay Hardie	Non-Executive Director
Maureen Laurie	Non-Executive Director
William Gennydd Thomas	Non-Executive Director
Derek James Weir	Non-Executive Director

## **INDEPENDENT REVIEW REPORT TO THE CO-OPERATIVE BANK PLC**

### **Introduction**

We have been engaged by the Bank to review the condensed set of financial statements in the Interim Financial Report for the six months ended 30 June 2014 which comprises the consolidated income statement, the consolidated statement of comprehensive income, the consolidated statement of financial position, the consolidated statement of cash flows, the consolidated statement of changes in equity and the related explanatory notes 1 to 20. 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 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 set of financial statements included in this Interim 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 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 set of financial statements in the Interim Financial Report for the six months ended 30 June 2014 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 not modified, we have considered the adequacy of the disclosure made in note 1.3 to the Interim Financial Report concerning the Bank's ability to continue as a going concern. The matters explained in note 1.3 to the Interim Financial Report, represent a material uncertainty which may cast significant doubt upon the Bank's ability to continue as a going concern. The condensed set of financial statements does not include the adjustments that would result if the Bank was unable to continue as a going concern.

## The Bank Interim financial report

### The Bank income statement

For the period ended 30 June 2014 (unaudited)

All amounts are stated in £m unless otherwise indicated

	Notes	Period to 30 June 2014	Restated Period to 30 June 2013
Interest receivable and similar income	5	566.3	707.6
Provision for potential customer redress claims	5	(25.0)	(39.0)
		541.3	668.6
Interest expense and similar charges	5	(363.4)	(470.8)
<b>Net interest income</b>		<b>177.9</b>	<b>197.8</b>
Fee and commission income	6	104.9	116.2
Provision for potential customer redress claims	6	(5.0)	(94.0)
		99.9	22.2
Fee and commission expense	6	(36.9)	(36.2)
<b>Net fee and commission income / (expense)</b>		<b>63.0</b>	<b>(14.0)</b>
Net trading income		0.2	1.1
Other operating (costs) / income		(1.6)	25.6
<b>Operating income</b>		<b>239.5</b>	<b>210.5</b>
<b>Operating expenses</b>			
Operating expenses	7	(401.9)	(411.0)
Intangible asset impairment		-	(148.4)
<b>Total operating expenses</b>		<b>(401.9)</b>	<b>(559.4)</b>
<b>Operating loss before impairment losses</b>		<b>(162.4)</b>	<b>(348.9)</b>
Impairment gains / (losses) on loans and advances	10	86.7	(496.0)
<b>Operating loss</b>		<b>(75.7)</b>	<b>(844.9)</b>
Share of post tax (losses) / profits from joint ventures		(0.1)	0.3
<b>Loss before taxation</b>		<b>(75.8)</b>	<b>(844.6)</b>
Income tax	9	19.1	39.4
<b>Loss for the financial period</b>		<b>(56.7)</b>	<b>(805.2)</b>
Attributable to:			
Equity shareholders		(57.6)	(805.5)
Non-controlling interests		0.9	0.3
		(56.7)	(805.2)
<b>Earnings per share (basic and fully diluted)</b>		<b>(20.35)p</b>	<b>(9.82)p</b>

In total £38.6m (2013: £163.0m) of conduct and legal provisions have been incurred during the period. This includes £25.0m (2013: £39.0m) reported within interest receivable and similar income, £5.0m (2013: £94.0m) reported within fee and commission income and £8.6m (2013: £30.0m) reported within operating expenses. Further details can be found in note 13.

The change in earnings per share (EPS) is largely due to the cancellation of 8.2bn ordinary shares as part of the Bank's Liability Management Exercise on 20 December 2013. Had the EPS been calculated based on the number of outstanding shares as at 30 June 2014, the EPS would have been (12.8)p (2013 restated: (178.4)p). This transaction was described in the 2013 Annual Report and Accounts and the effect on share capital can be seen in note 18.

Comparative figures for the period to 30 June 2013 have been restated as described in note 3.

The notes accompanying these financial statements are shown below.

### The Bank statement of comprehensive income

For the period ended 30 June 2014 (unaudited)

All amounts are stated in £m unless otherwise indicated

	Period from 1 Jan 2014 to 30 June 2014			Restated Period from 1 Jan 2013 to 30 June 2013		
	Equity shareholders	Non-controlling interests	Total	Equity shareholders	Non-controlling interests	Total
<b>(Loss)/Profit for the period</b>	<b>(57.6)</b>	<b>0.9</b>	<b>(56.7)</b>	<b>(805.5)</b>	<b>0.3</b>	<b>(805.2)</b>
<b>Other comprehensive (expense)/income that may be recycled to profit and loss:</b>						
Changes in cashflow hedges						
Net changes in fair value recognised directly in equity	<b>(6.6)</b>	<b>(0.3)</b>	<b>(6.9)</b>	(34.4)	(0.5)	(34.9)
Income tax	<b>0.4</b>	-	<b>0.4</b>	9.2	0.1	9.3
Transfers from equity to income or expense	<b>(5.3)</b>	-	<b>(5.3)</b>	(10.6)	-	(10.6)
Income tax	<b>(0.3)</b>	-	<b>(0.3)</b>	2.4	-	2.4
Changes in available for sale assets						
Net changes in fair value recognised directly in equity	<b>18.0</b>	-	<b>18.0</b>	(44.4)	-	(44.4)
Income tax	<b>(3.9)</b>	-	<b>(3.9)</b>	10.0	-	10.0
Transfers from equity to income or expense	<b>(12.4)</b>	-	<b>(12.4)</b>	13.4	-	13.4
Income tax	<b>2.7</b>	-	<b>2.7</b>	(3.1)	-	(3.1)
Other comprehensive (expense)/income for the period, net of income tax	<b>(7.4)</b>	<b>(0.3)</b>	<b>(7.7)</b>	<b>(57.5)</b>	<b>(0.4)</b>	<b>(57.9)</b>
<b>Total comprehensive (expense)/income for the period</b>	<b>(65.0)</b>	<b>0.6</b>	<b>(64.4)</b>	<b>(863.0)</b>	<b>(0.1)</b>	<b>(863.1)</b>

The 2013 comparatives have been restated as described in note 3.

The notes accompanying these financial statements are shown below.

### The Bank statement of financial position

At 30 June 2014 (unaudited)

All amounts are stated in £m unless otherwise indicated

	Notes	30 June 2014	Restated 31 December 2013	Restated 31 December 2012
<b>Assets</b>				
Cash and balances at central banks		<b>6,103.7</b>	5,418.8	5,433.0
Loans and advances to banks		<b>1,644.6</b>	1,594.4	1,904.1
Loans and advances to customers	10a	<b>27,836.4</b>	30,322.2	33,339.5
Fair value adjustments for hedged risk	10b	<b>58.0</b>	106.3	354.2
Investment securities - loans and receivables	11a	<b>16.0</b>	23.6	295.0
Investment securities - available for sale	11b	<b>2,925.2</b>	2,732.4	3,789.4

Investment securities - fair value through income or expense	11c	<b>1,256.7</b>	1,743.4	1,845.2
Investment securities - held for trading		-	-	960.2
Derivative financial instruments		<b>440.5</b>	555.8	818.8
Equity shares		<b>5.8</b>	5.8	5.7
Investments in joint ventures		<b>4.6</b>	4.7	3.9
Investment properties		<b>158.0</b>	164.1	173.0
Property, plant and equipment		<b>114.0</b>	115.2	113.4
Intangible fixed assets		<b>93.6</b>	110.7	263.2
Amounts owed by other Co-operative Group undertakings		-	-	56.8
Other assets		<b>400.3</b>	480.9	70.3
Prepayments and accrued income		<b>16.0</b>	16.5	14.9
Current tax assets		-	-	172.6
Deferred tax assets	14	<b>3.2</b>	2.5	159.6
<b>Total assets</b>		<b>41,076.6</b>	43,397.3	49,772.8

#### Liabilities

Deposits by banks		<b>2,136.3</b>	2,757.5	3,612.0
Customer accounts		<b>31,070.1</b>	32,463.3	35,884.4
Customer accounts - capital bonds	12	<b>388.9</b>	538.1	888.1
Debt securities in issue		<b>3,880.8</b>	4,207.6	4,716.2
Derivative financial instruments		<b>481.1</b>	538.6	967.6
Other borrowed funds		<b>196.3</b>	196.3	1,258.6
Amounts owed to other Co-operative Group undertakings		-	-	190.0
Other liabilities		<b>166.7</b>	202.9	104.0
Accruals and deferred income		<b>17.4</b>	54.1	20.1
Provisions for liabilities and charges	13	<b>544.8</b>	549.7	137.9
Current tax liabilities		<b>1.2</b>	4.2	-
Deferred tax liabilities	14	<b>77.8</b>	92.5	121.4
<b>Total liabilities</b>		<b>38,961.4</b>	41,604.8	47,900.3

#### Capital and reserves attributable to the Bank's equity holders

Ordinary share capital	18	<b>22.6</b>	12.5	410.0
Share premium account	18	<b>1,736.9</b>	1,359.8	8.8
Retained earnings		<b>(87.4)</b>	(29.7)	1,323.2
Available for sale reserve		<b>(9.7)</b>	(14.1)	30.0
Capital redemption reserve		<b>410.0</b>	410.0	-
Cashflow hedging reserve		<b>8.6</b>	20.4	67.1
		<b>2,081.0</b>	1,758.9	1,839.1
Non-controlling interests		<b>34.2</b>	33.6	33.4
<b>Total equity</b>		<b>2,115.2</b>	1,792.5	1,872.5

<b>Total liabilities and equity</b>		<b>41,076.6</b>	43,397.3	49,772.8
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The 2013 comparatives have been restated as described in note 3.

Approved by the Board on 21 August 2014:

**Richard Pym**, Chair

**Niall Booker**, Chief Executive

The notes accompanying these financial statements are shown below.

#### The Bank statement of cash flows

For the period ended 30 June 2014 (unaudited)

All amounts are stated in £m unless otherwise indicated

	30 June 2014	Restated 30 June 2013
<b>Cash flows used in operating activities</b>		
Loss before taxation	(75.8)	(844.6)
Adjustments for:		
Decrease in prepayments and accrued income	0.5	(7.7)
(Decrease)/increase in accruals and deferred income	(36.7)	23.9
Interest payable in respect of other borrowed funds	11.3	45.3
Effect of exchange rate movements	(0.4)	(12.8)
Fair value movement on investment properties	5.9	18.9
Impairment (gains) / losses on loans and advances	(86.7)	495.8
Movements on investment impairments	(1.1)	(19.0)
Depreciation and amortisation	19.9	20.8
Impairment of intangible fixed assets	0.4	2.0
Interest amortisation	(3.3)	(0.2)
Fair value movements and amortisation of investment securities	(45.8)	53.9
Impairment of property, plant and equipment	7.0	9.9
Loss on disposal of property, plant and equipment	0.2	-
Unwind of fair value adjustments arising on transfer of engagements	47.1	8.2
Preference dividend	-	2.8
	<b>(157.5)</b>	<b>(202.8)</b>
Decrease in deposits by banks	(617.6)	(94.2)
Decrease in customer accounts and capital bonds	(1,566.6)	(1,850.1)
Decrease in debt securities in issue	(361.6)	(136.1)
Decrease/(increase) in loans and advances to banks	20.0	(41.4)
Decrease in loans and advances to customers	2,644.0	291.2
Decrease in amounts owed by other Co-operative Group undertakings	-	239.9
Increase in amounts owed to other Co-operative Group undertakings	-	11.9
Net movement of other assets and other liabilities	(88.7)	(213.7)
Income tax received	5.3	16.4
<b>Net cash flows used in operating activities</b>	<b>(122.7)</b>	<b>(1,978.9)</b>
<b>Cash flows from investing activities</b>		
Purchase of tangible and intangible fixed assets	(11.4)	(0.5)
Proceeds from sale of property, plant and equipment	2.4	-
Proceeds from sale of investment property	-	1.3
Purchase of investment securities	(1,112.2)	(2,033.8)
Proceeds from sale and maturity of investment securities	1,526.9	3,875.2
<b>Net cash flows from investing activities</b>	<b>405.7</b>	<b>1,842.2</b>
<b>Cash flows from/(used in) financing activities</b>		
Interest paid on other borrowed funds	(11.4)	(44.3)
Dividends paid to non-controlling interests	-	(0.1)
Preference share dividends paid	-	(2.8)
Capital Commitment received from the Co-operative Group	150.0	-
Costs incurred relating to the May 2014 Capital Raising	(12.8)	-
Cash proceeds relating to the May 2014 Capital Raising	400.0	-
<b>Net cash flows from/(used in) financing activities</b>	<b>525.8</b>	<b>(47.2)</b>
<b>Increase/(decrease) in cash and cash equivalents</b>	<b>808.8</b>	<b>(183.9)</b>
<b>Cash and cash equivalents at the beginning of the period</b>	<b>6,092.2</b>	<b>6,314.2</b>
<b>Cash and cash equivalents at the end of the period</b>	<b>6,901.0</b>	<b>6,130.3</b>
Cash and balances with central banks	6,041.2	5,331.7
Loans and advances to banks	704.8	673.6
Short term investments (note 11)	155.0	125.0
	<b>6,901.0</b>	<b>6,130.3</b>

The cash flows differ from the Bank balance sheet movements as these movements include the non-cash unwinds of the fair value adjustments arising on the Britannia Building Society merger.

Following the change in the ownership of the Bank, amounts owed to and by Co-operative Group undertakings are classified as at 30 June 2014 as third party balances.

The 2013 comparatives have been restated as described in note 3.

The notes accompanying these financial statements are shown below.

### The Bank statement of changes in equity

For the period ended 30 June 2014 (unaudited)

All amounts are stated in £m unless otherwise indicated

	Attributable to equity holders of the Bank						Total	Non-controlling interest	Total equity
	Share capital	Share premium	Available for sale reserve	Cashflow hedging reserve	Capital redemption reserve	Retained earnings			
<b>Period from 1 January 2014 to 30 June 2014</b>									
Balance at the beginning of the period (as restated)	12.5	1,359.8	(14.1)	20.4	410.0	(29.7)	1,758.9	33.6	1,792.5
Total comprehensive (expense)/income for the period	-	-	4.4	(11.8)	-	(57.6)	(65.0)	0.6	(64.4)
Transactions with owners recorded directly in equity:									
Issuance of new share capital	10.1	389.9	-	-	-	-	400.0	-	400.0
Transaction costs	-	(12.8)	-	-	-	-	(12.8)	-	(12.8)
Dividend	-	-	-	-	-	(0.1)	(0.1)	-	(0.1)
<b>Balance at the end of the period</b>	<b>22.6</b>	<b>1,736.9</b>	<b>(9.7)</b>	<b>8.6</b>	<b>410.0</b>	<b>(87.4)</b>	<b>2,081.0</b>	<b>34.2</b>	<b>2,115.2</b>
<b>Period from 1 July 2013 to 31 December 2013</b>									
Balance at the beginning of the period (as restated)	410.0	8.8	5.9	33.7	-	517.7	976.1	33.2	1,009.3
Total comprehensive (expense)/income for the period	-	-	(20.0)	(13.3)	-	47.4	14.1	0.5	14.6
Transactions with owners recorded directly in equity:									
Liability Management Exercise									
Cancellation of share capital	(410.0)	-	-	-	410.0	-	-	-	-
Issuance of new share capital	12.5	777.5	-	-	-	-	790.0	-	790.0
Transfer of retained earnings to share premium	-	594.8	-	-	-	(594.8)	-	-	-
Transaction costs	-	(21.3)	-	-	-	-	(21.3)	-	(21.3)
Dividend	-	-	-	-	-	-	-	(0.1)	(0.1)
Balance at the end of the period (as restated)	12.5	1,359.8	(14.1)	20.4	410.0	(29.7)	1,758.9	33.6	1,792.5

### Period from 1 January 2013 to 30 June 2013

Balance at the beginning of the period (as restated)	410.0	8.8	30.0	67.1	-	1,323.2	1,839.1	33.4	1,872.5
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Total comprehensive (expense)/income for the period (as restated)	-	-	(24.1)	(33.4)	-	(805.5)	(863.0)	(0.1)	(863.1)
Transactions with owners recorded directly in equity:									
Dividend	-	-	-	-	-	-	-	(0.1)	(0.1)
Balance at the end of the period (as restated)	410.0	8.8	5.9	33.7	-	517.7	976.1	33.2	1,009.3

During the period a securitisation vehicle was closed and a dividend payment of £0.1m (2013: £nil) was made to its respective holding company. This amount was subsequently paid out to charitable organisations.

The 2013 comparatives have been restated as described in note 3.

The notes accompanying these financial statements are shown below.

## Notes to the Bank Interim financial report

For the period ended 30 June 2014 (unaudited)

All amounts are stated in £m unless otherwise indicated

### 1. Basis of preparation and significant accounting policies

#### 1.1 Basis of preparation

This condensed consolidated Interim Financial Report for the half year ended 30 June 2014 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 2013 financial statements, which have been prepared in accordance with IFRS as adopted by the European Union.

The information contained within this report for the year ended 31 December 2013 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, 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 comparative information presented within the Interim Financial Report 2014 reflects the information disclosed within the Prospectus prepared to support the Liability Management Exercise dated 4 November 2013 (restated as explained in note 3) and not the information presented within the Interim Financial Report 2013.

The Interim Financial Report 2014 was approved by the Board of Directors on 21 August 2014.

#### 1.2 Significant accounting policies

In the current period, the Bank has adopted IFRIC 21 – Levies, resulting in a prior period adjustment being made within the Interim Financial Report 2014 (see note 3). The following additional pronouncements were applicable in the current period but did not have a significant impact on the Bank:

- IFRS 10 Consolidated Financial Statements - Amendments for investment entities
- IFRS 11 Joint arrangements
- IFRS 12 Disclosure of Interests in Other Entities - Annual periods beginning on or after 1 January 2014
- IAS 27 Separate Financial Statements - Amendments for investment entities
- IAS 32 Financial Instruments: Presentation - Amendments relating to the offsetting of assets and liabilities
- IAS 36 Impairment of Assets - Amendments arising from Recoverable Amount Disclosures for Non-Financial Assets
- IAS 39 Financial Instruments: Recognition and Measurement - Amendments for novations of derivatives

Otherwise, with exception to the matters disclosed in note 3, the same accounting policies and presentation are followed in the Interim Financial Statements 2014 as applied in the 2013 Annual Report and Accounts. Significant additions and changes to underlying methodologies are discussed within the critical judgements and estimates section.

An overview of pronouncements that will be relevant to the Bank in future periods is provided in the 2013 Annual Report and Accounts. The IASB has issued further pronouncements; however, the Bank does not expect adoption of any of the new guidance to have a significant impact on its results with the exception of IFRS 9 and IFRS 15.

IFRS 9 Financial Instruments was issued in July 2014 and supersedes IAS 39 Financial Instruments: Recognition and Measurement. The standard includes requirements for recognition and measurement, impairment, derecognition and general hedge accounting. Due to the short period of time which has elapsed since the issue of the standard, the Bank has not yet estimated the financial effects, although it is expected that IFRS 9 will have a significant impact for the Bank, in line with the wider industry. The standard is mandatory for periods beginning on or after 1 January 2018 but is available for early adoption subject to EU endorsement.

IFRS 15 Revenue From Contracts With Customers was issued in May 2014 and supersedes IAS 18 'Revenue', IAS 11 'Construction Contracts' and a number of revenue-related interpretations. Due to the short period of time which has elapsed since the issue of the standard, the Bank has not yet estimated the financial effects of the standard. The standard will be effective for annual reporting periods beginning on or after 1 January 2017 subject to EU endorsement.

#### 1.3 Going concern

## **a. Introduction**

These financial statements are prepared on a going concern basis. The Directors have a reasonable expectation that the Bank will have the resources to continue in business for the foreseeable future, taking into account the matters referred to below.

The assessment of the appropriateness of using the going concern basis of accounting 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 processes, and discussion with the PRA. This analysis included a particular focus on the 12 month period ending 31 August 2015. The forecasts included in the 2014-2018 Business Plan have been subjected to stressed scenarios which the Board considered to be reasonable and appropriate.

Following the capital shortfall identified in 2013, and the subsequent successful capital raising exercises, the Bank is now in the early stages of its Turnaround Plan (incorporated into the Business Plan discussed above). The completion of this Plan is expected to take 4-5 years and involves reshaping and restructuring the business as a core relationship bank.

The completion of the capital raising exercises removed major elements of uncertainty around the going concern status of the Bank. However, whilst important steps, these are not in themselves sufficient to recapitalise the Bank in the long term. There continue to be material uncertainties around the Bank's ability to continue as a going concern which relate to the implementation of the Turnaround Plan as discussed in (e) below. In particular, the Bank needs the ongoing forbearance of the PRA regarding its ICG deficit in accepting and moving forwards with its plan.

## **b. The Turnaround Plan - refocus on Core relationship banking proposition**

The Co-operative Bank is a recognised brand and continues to maintain a loyal customer base. Our strategy is to reshape the business as a core relationship bank providing standard business banking and retail banking services to individuals and SMEs. Restructuring the business, including a reduction in head office costs, to drive a significant reduction of the cost base is an important part of the overall strategy.

A key element of the reshaping of the business is the reduction in the Non-core banking business and assets, which carry the majority of the risk weighted assets of the Bank currently. Reducing the risk weighted assets of the Bank will improve its Basel III CET1 and leverage ratios.

## **c. Capital**

In line with expectations, the Bank remains below the Individual Capital Guidance (ICG) for total capital set by the PRA and it is forecast to remain so for most of the duration of the 2014 – 2018 planning period. The PRA has reviewed and accepted the 2014-2018 Business Plan. The Bank needs the ongoing forbearance of the PRA regarding its ICG deficit in accepting and moving forwards with its plan.

Total CRD IV capital resources as at 30 June 2014 are £1.6bn (31 December 2013: £1.1bn). The Bank's CET1 ratio stands at 11.5% (31 December 2013: 7.2%<sup>1</sup>) on a CRD IV end point basis.

<sup>1</sup> Following the restatement discussed in note 3, CET1 ratio would be 7.3% as at 31 December 2013. This restatement will be part of the regulatory capital calculation only once formally audited.

## **d. Liquidity**

Since 31 December 2013, the liquid asset ratio has increased to 18.5% as at 30 June 2014 (31 December 2013: 16.0%). This liquid asset ratio improvement is due to a reduction in total assets, and an increase in primary liquidity. The Bank continues to maintain a liquidity position above regulatory minima.

During the period to 30 June 2014, the Bank has actively managed a reduction in customer deposits of £1.5bn with a reduction in customer assets of £2.5bn. Within the aggregate £1.5bn customer deposit reduction in the six months to 30 June 2014, Retail customer deposits decreased by £0.7bn.

## **e. Risks and uncertainties**

Key risks associated with successful execution of the Turnaround Plan include:

- i) The Bank needs the ongoing forbearance of the PRA regarding its ICG deficit in accepting and moving forwards with its plan. To the extent this is not forthcoming or to the extent that the Bank does not perform in line with its 2014-2018 Business Plan or regulatory capital requirements are increased for any reason, additional CET1 capital may be required over and above that included in that plan in order for the Bank to remain a going concern, and the PRA could exercise its powers under the Banking Act of 2009.
- ii) As referred to above, the continued ability of the Co-operative Group (via the Co-operative Banking Group Limited) to make the remaining 2014 contribution of £163m and to meet its other commitments to the Bank as they fall due. To date, all payments have been paid when due. Based on all the information provided by the Co-operative Group, and on investigations made by and on behalf of the Bank, the Bank believes that the incorporation of this contribution into its plans is appropriate;
- iii) On 20 December 2013, the Bank began the process of separating its operations from its former parent, the Co-operative Banking Group Limited, and its ultimate former parent, the Co-operative Group, with both of which it shares premises, systems and services. The work is complex and time consuming and there remains a risk that the costs of executing these separation plans may increase. The potential misalignment of Group and Bank's objectives may also make separation slower and more costly than anticipated;
- iv) The Bank participates in the Co-operative Group's defined benefit pension scheme (Pace). 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 cause the Bank to require further capital in addition to that referred to above; and
- v) More generally the ability of the Bank to achieve the results set out in the 2014-2018 Business Plan. In this respect particular challenges 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; meeting its planned improvements in net interest margin; the ability of the Bank to generate sufficient asset growth; a possible further deterioration in the quality of the Bank's asset portfolio; unplanned costs from (for example) conduct risk matters, regulatory investigations, IT investment and the ability to maintain the Bank's access at an appropriate cost to liquidity and funding; and

## **f. Conclusion**

The Directors have concluded that despite delivering lower than expected losses and higher CET1 for the half year ended 30 June 2014, the risks set out above, and their consequential effects, represent a material uncertainty which may cast significant doubt upon the Bank's ability to continue as a

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<sup>1</sup> Following the restatement discussed in note 3, CET1 ratio would be 7.3% as at 31 December 2013. This restatement will be part of the regulatory capital calculation only once **formally** audited.



going concern. Nevertheless, after making enquiries and considering the current forecasts, in particular those for the period up to and including 31 August 2015, the Directors have a reasonable expectation that the Bank will have adequate resources to continue in business over this period. For these reasons, they continue to adopt 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 are those relating to loan impairment provisions, conduct risk and legal provisions, deferred tax, pensions and hedge accounting.

### **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 flows, 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. Where required, management also periodically adjust collective provisions for additional risk parameters upon existing individual and collective impairment models.

Further explanation of the treatment of forbore balances is included in the Bank's risk management disclosures.

The section below explains the methodology for loan impairment for both the Core (unsecured and secured residential) and Non-core (Corporate and Optimum) segments. Only the critical elements of judgement are discussed in detail.

#### **ii. Collective provisions**

Loans which have not been individually impaired 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 £198.0m (31 December 2013: £167.8m). Loans are identified as impaired by taking account of the stage of the debt's delinquency, the product type and the regularity of payments made whilst in arrears. The provision is calculated by applying a percentage rate to different categories and ages of impairment debt.

The provision rates reflect the likelihood that the debt in that category/age will be written off or charged off at some point in the future. The rates are based on historical experience and current trends, which incorporate the effects of discounting at the customer interest rate and are subject to regular review. The provision is the product of the rate and the balance for the relevant arrears segment.

The unsecured provisions rely heavily on assumed probabilities of default.

A key estimate within the provisioning model is the discounted percentage provision rates applied to all personal loans subject to impairment. The most significant risk resides with credit card loans. A 5% (percentage point) change across these provision rates would change the collective provision by £24.6m.

There were no significant changes made to the collective provision methodology in 2014.

##### **b) Non-core**

###### **i) Corporate**

The Bank's collective provision against corporate loans in the Non-core division has decreased to £26.8m (31 December 2013: £40.0m).

The collective provision is calculated using factors such as observed default rates and loss given default. An assessment is made of the likelihood of the assets becoming recognised as impaired in the loss emergence period.

The formula underpinning this methodology relies heavily on assumed probabilities of default:

Drawn Balance (£) x Probability of Default (%) x Loss Given Default (%) x Loss emergence period six months (as a fraction of 12 months). The Probability of Default and Loss Given Default are based on observed default propensities and loss events in this portfolio.

The reduction in the collective provision is primarily due to the planned deleveraging of Non-core assets of the Bank and the write off of loans in 2014. There were no significant changes made to the collective provision methodology in 2014 with the exception of the reduction in the Loss Emergence Period (LEP) from 9 to 6 months. The reduction in the LEP resulted in a decrease in the provision of £2.8m. The LEP was calculated with reference to recently experienced data.

A key estimate within the corporate collective model is the LEP. A movement of one month in this estimate would change the provision by £1.0m. There is a linear relationship between the change in LEP and the change in provision.

## ii) Optimum collective

In addition to the above, collective provisions of £11.2m (31 December 2013: £9.4m) are held in the Optimum segment of the Non-core business.

There were no significant changes made to the collective provision methodology in 2014.

Further explanation of collective loan impairment method is included in the Bank's risk management disclosures.

## 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 loans.

### a) Core

#### i) Unsecured and secured residential

Individual provisions for unsecured and secured residential lending total £8.5m (31 December 2013: £10.7m). There were no significant changes made to the provision methodology in 2014.

### b) Non-core

#### i) Corporate

The Bank's impairment provision on corporate loans totals £504.3m (31 December 2013: £698.4m). The provision has decreased reflecting improving macro economic factors and the Bank's strategy of reduction of its Non-core assets.

Each corporate account is assessed and allocated a 'risk grade' to enable the Bank to monitor the overall quality of its lending assets. Those of lesser quality, where the lending is potentially at risk and loss provisions may be required, are centrally monitored. Provisions represent the likely net loss after realisation of any security.

There were no significant changes made to the provision methodology in 2014 reflecting comparable macro economic factors with the 2013 year end.

A key estimate within the corporate individual impairment model is collateral valuation. A 10% movement in this estimate would change the provision by £77.2m.

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

## ii) Optimum individual

The Bank's individual impairment provision on Optimum mortgages is £13.0m (31 December 2013: £26.1m). Mortgage accounts are identified as impaired and provided for on an individual basis by taking account of the stage of the debt's delinquency.

There were no significant changes made to the provision methodology in 2014. The decrease in the provision reflects the improving quality of the loan book and improved HPI values.

## b. Conduct risk and legal 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.

Significant components of the conduct risk and legal provision are potential customer redress in relation to Payment Protection Insurance (PPI), interest rate swaps and technical breaches of the Consumer Credit Act. The Bank has also made provision for conduct provisions which are individually less significant. In total a charge of £38.6m (30 June 2013: £166.7m, including £3.7m redress costs included within operating expenditure) has been made during the period.

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, the level of complaints, uphold rates, proactive contact and response rates and Financial Ombudsman Service referral and uphold rates.

### ii. Payment Protection Insurance

A provision of £96.5m (31 December 2013: £133.8m) has been recorded in respect of potential customer redress relating to past sales of Payment Protection Insurance ("PPI"). The provision is in respect of the total expected cost to the Bank of carrying out this work and paying compensation, making total provisions raised to date of £352m (31 December 2013: £347m).

The additional provision recorded during the period of £5m results from a number of factors. The most significant factors include the calculation of single premium PPI redress based on full redress rather than redress based on an equivalent regular premium PPI and the application of further guidance from Financial Ombudsman Service in relation to late fees.

There are a number of key assumptions within the calculation of the current provision. The key assumptions within the calculation of the current provision are the complaint volumes, the uphold rates, the administration cost base, proactive response rate and retrospective redress.

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

#### Bank PPI assumptions table

Description of estimate	Current position	Future expected	Sensitivity on current position
Number of inbound valid*1 complaints	78,000	20,000	1,000 = £1.5m
Number of proactive mailings	36,000	12,000	1,000 = £1.9m
Response rate to proactive mailings	62%	63%	1% = £1.4m
Average uphold rate per valid*1 complaint	63%	59%	1% = £0.7m
Average redress per upheld	£3,237	£2,530	£100 = £1.6m

complaint			
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(Note \*1, valid complaints excludes those complaints for which no PPI policy exists).

These assumptions remain subjective, in particular due to the uncertainty associated with future claims levels. The resulting provision represents the Bank's 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. The provision also includes an estimate of the Bank's claims handling costs and those costs associated with claims that are subsequently referred to the Financial Ombudsman Service.

### iii. Interest rate swap mis-selling

The Bank previously voluntarily agreed to participate in the FSA's Interest Rate Hedging (IRH) Past Business Review (PBR).

A provision of £25.6m (31 December 2013: £33.0m) for potential interest rate swap mis-selling has been recorded at 30 June 2014. The decrease in the provision reflects the utilisation of the provision in the period.

Calculations on redress have been performed based upon the latest guidance from both the FCA and a Skilled Person (as defined by the FCA). The final redress method has not, however, been confirmed in all cases.

There are a number of key assumptions within the calculation of the current provision. The key assumptions within the calculation of the current provision are the population of in scope swaps and the methodology to calculate redress provision.

Where redress methods change, the value will also change. It has also been assumed that customers who opted out of the initial review of interest rate hedging products will subsequently choose to be placed back in the review, as is their right. The provision assumes that no redress will be required for potential future claims for consequential losses.

### iv. Breaches of the technical requirements of the Consumer Credit Act (legal provision)

An amount of £136.5m (31 December 2013: £109.5m) has been recognised regarding interest refunds following identification of a number of breaches of the highly technical requirements of the Consumer Credit Act.

The increase in the provision reflects the interest chargeable on the related loan in accordance with the relevant loan agreements in this six month period. The provision will increase in line with interest charged in the period every period until the issue is resolved.

Assumptions for provisioning purposes are that the payment profile of loans was as per those agreed at drawdown. The provision covers all interest accrued during non-compliance to the end of June 2014. Until loans are returned to a compliant state which is expected in H2 of 2014, the ongoing cost is up to £0.1m per day leading to a probable increase in the total provision of £18m in the second half of 2014.

Within the provision, operating costs of £11m are based upon the latest view of delivery timeframes.

### v. Other conduct/compliance related provisions

Other conduct/compliance related provisions include the following:

- £37.6m (31 December 2013: £29.0m) for potential customer redress relating to the processing of first payments on certain mortgages;
- £31.0m (31 December 2013: £31.0m) relating to potential customer redress in relation to mortgage fees;
- £26.1m (31 December 2013: £26.1m) for alleged failings in the introduction of third party sales of card and identification protection products;
- £22.0m (31 December 2013: £22.0m) relating to potential customer redress on secured arrears;
- £14.0m (31 December 2013: £15.0m) for potential customer redress in relation to arrears charges;
- £15.0m (31 December 2013: £15.0m) relating to provision for potential conduct issues incurred but not reported;
- £9.0m (31 December 2013: £13.0m) relating to potential customer redress and other costs in relation to mortgage documentation; and
- £9.9m (31 December 2013: £10.9m) of other conduct provisions.

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

The above provisions have a significant range of highly judgemental outcomes, the most significant of which reside within the provision for alleged failings in the introduction of third party sales of card and identification protection products. Given the Bank has relatively limited levels of actual experience for estimates within this provision, it carries the inherent risk of forecasting for subjective final outcomes. For example, customer response ratios to the proactive customer contact programme, or an extension to the time period, for which a proactive customer contact programme is required. A change in the overall estimates for outcomes could increase the provision by up to £52m.

### c. Deferred tax

The Bank has recognised a deferred tax asset of £3.2m (31 December 2013: £2.5m restated) and a deferred tax liability of £77.8m (31 December 2013: £92.5m). The deferred tax liability has been calculated using a tax rate of 20%.

The deferred tax asset relates to temporary differences arising on consolidation adjustments and the taxation of SPEs in the securitisation regime. The deferred tax asset has been recognised on the basis that its recoverability is not dependent on the future performance of the Bank.

### d. Pensions

#### i. Defined contribution accounting for the Pace scheme

The Bank participates in The Co-operative Pension Scheme (Pace). Pace is a hybrid scheme, consisting of a 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 liability in respect of this multi-employer scheme. For this reason the 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.

## ii. Defined benefit accounting for the Britannia scheme

The Britannia scheme is a hybrid scheme, consisting of a defined benefit section and a defined contribution section. In 2009, following the transfer of engagements of Britannia Building Society, CFSMS, a Co-operative Group subsidiary, became principal employer of the scheme. The Bank and three wholly owned subsidiaries (Platform, WMS and Britannia International) are participating employers in this multi-employer scheme.

Following the continued separation of the Bank from the wider Co-operative Group, the Britannia scheme is now accounted for on a defined benefit basis within the accounts of the Bank. Further information on the financial implications of accounting for the Britannia scheme on a defined benefit basis is disclosed in note 15.

## e. Hedge accounting

The Bank reviewed its hedge accounting methodology in the period and concluded that the method for calculating hedge ineffectiveness should be revised to better align with industry practices under IAS 39 (Financial Instruments: Recognition and Measurement). This has resulted in the recognition of an accounting loss in the period and a restatement of prior periods.

These changes will result in additional accounting volatility in future financial periods, although this merely represents changes in the timing of recognition of profit or loss and not in the overall economic value of the hedge itself.

## 3. Restatements

This note provides details of restatements for hedge accounting, IFRIC 21 levies and CFSMS assets.

The comparative information presented within the Interim Financial Report 2014 reflects the information disclosed within the Prospectus prepared to support the Liability Management Exercise dated 4 November 2013 (restated as explained below) and not the information presented within the Interim Financial Report 2013.

### Hedge accounting

The Bank elects to make use of different hedge accounting techniques in order to eliminate (as far as possible) any profit or loss generated purely through the implementation of accounting standards (as opposed to actual economic losses).

The Bank applies two types of hedge accounting - cashflow hedge accounting and fair value hedge accounting. These hedging methodologies are used on both a micro basis (one underlying asset or liability hedged by one derivative) or a macro basis (a portfolio of assets or liabilities hedged by a combination of derivatives).

The Bank has reviewed its hedge accounting strategies and the interpretations applied to hedge accounting in accordance with IAS 39 and best practice. Based on this review the Bank has amended its calculation of hedge ineffectiveness resulting from these models and retrospectively restated prior year results for the change in methodology. The result of this change in policy is that the Bank now accounts for additional sources of accounting hedge ineffectiveness through the income statement (accounting hedge ineffectiveness may occur even though the hedge is economically perfect).

### IFRIC 21 Levies

This interpretation provides guidance on accounting for the liability to pay a government imposed levy and has resulted in a change in the timing of recognition of Financial Services Compensation Scheme (FSCS) levies that impact the Bank.

The Bank has an obligation to contribute to the FSCS to enable the scheme to meet interest, capital and administrative costs of safeguarding the protected deposits of savers in financial institutions that have failed. The scheme year is from 1 April to 31 March and levies are calculated on the proportion of the deposit taker's protected deposits at the preceding 31 December.

In previous years, the Bank recognised the FSCS levy in accordance with IAS 37 on the basis that the obligating event was being a deposit taker on the 31 December preceding the FSCS scheme year so that in the 31 December 2013 Annual Report and Accounts, an estimated provision in respect of the 2014/15 levy was recognised. IFRIC 21 clarified that the obligating event that gives rise to a liability to pay a levy is the event that triggers the payment of the levy and this is the case even if the levy is calculated by reference to revenue generated in the previous period. As FSCS can only raise a levy within its scheme year, under IFRIC 21 the Bank should only recognise a provision in the scheme year itself. As such, the 2014/15 levy should be recognised in the Bank's 2014 Annual Report and Accounts.

IFRIC 21 is applicable for accounting periods beginning on or after 1 January 2014. The change has been applied retrospectively and the comparatives restated accordingly.

The effect of the prior period restatements on the Bank are:

<u>Statement of financial position</u>	Note	1 January 2013		1 January 2013	31 December 2013	31 December 2013	
		(as reported)	Adjustment	(restated)	(as reported)	Adjustment	(restated)
<b>Assets</b>							
Fair value adjustments for hedged risk	10b	354.2	-	354.2	107.6	(1.3)	106.3
<b>Liabilities</b>							
Debt securities in issue		4,713.7	2.5	4,716.2	4,195.3	12.3	4,207.6
Provisions for liabilities and charges	13	162.7	(24.8)	137.9	576.0	(26.3)	549.7
<b>Reserves</b>							
Retained earnings		1,304.3	-	-	(39.4)	-	-
Adjustment re FSCS levy		-	24.8	-	-	26.3	-
Adjustment for hedge accounting		-	(5.9)	1,323.2	-	(16.6)	(29.7)
		1,304.3	18.9	1,323.2	(39.4)	9.7	(29.7)
Cashflow hedging reserve		63.7	3.4	67.1	14.9	5.5	20.4

As part of the reserves restatement deferred tax assets have been recognised. Further details can be found in note 14

#### Income statement

The hedge accounting restatement gives rise to a restated presentation of items within net interest income. The IFRIC 21 levies restatement gives rise to a restated presentation of items within operating expenses. The impact of the restatements is shown below:

	Note	30 June 2013 (as reported)	Adjustment	30 June 2013 (restated)
<b>Net interest income - on financial instruments</b>				
hedging assets	5	(59.4)	(8.0)	(67.4)
<b>Other operating income</b>		26.0	(0.4)	25.6
FSCS levies	13	0.1	(24.8)	(24.7)
<b>Operating loss</b>		<b>(811.7)</b>	<b>(33.2)</b>	<b>(844.9)</b>
<b>Loss for the period before taxation</b>		<b>(811.4)</b>	<b>(33.2)</b>	<b>(844.6)</b>

The impact on regulatory capital is described in the Capital Management section in the Interim Financial Report.

The total impact of the IFRIC 21 levy adjustment as at 31 December 2013 is to reduce the year end FSCS provision by £26.3m to £13.3m, for the charge to reduce by £1.5m and the cumulative impact on reserves is an increase of £24.8m.

#### **CFSMS Assets**

In 2013 the accounting treatment of assets held on the books of CFSMS was reviewed and the conclusion reached that, as the Bank was substantially exposed to the risks and rewards of these assets, they should be held on the Bank's balance sheet. The impact of this is a re-classification within note 7, whereby £11.8m of administrative expenses in the period to June 2013 are now recorded as depreciation and amortisation. This is referred to in more detail in the 2013 Annual Report and Accounts.

#### **4. 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 the 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.

**Core**

**Non-core**

	Retail	BaCB	Treasury	Other <sup>1</sup>	Total Core	Corporate CoAM	Optimum	Illius	Total Non-core	Total
<b>Period to 30 June 2014</b>										
Net interest income	201.5	23.0	(9.3)	5.7	<b>220.9</b>	11.8	17.3	(2.1)	<b>27.0</b>	<b>247.9</b>
Non-interest income	55.9	7.9	(21.2)	3.1	<b>45.7</b>	14.5	2.4	(2.0)	<b>14.9</b>	<b>60.6</b>
<b>Operating income</b>	<b>257.4</b>	<b>30.9</b>	<b>(30.5)</b>	<b>8.8</b>	<b>266.6</b>	<b>26.3</b>	<b>19.7</b>	<b>(4.1)</b>	<b>41.9</b>	<b>308.5</b>
Direct costs	(78.4)	(8.7)	(7.2)	(4.2)	<b>(98.5)</b>	(9.3)	(2.6)	(2.3)	<b>(14.2)</b>	<b>(112.7)</b>
Impairment gains/(losses) on loans and advances	(1.3)	(1.4)	-	1.2	<b>(1.5)</b>	79.3	9.0	(0.1)	<b>88.2</b>	<b>86.7</b>
<b>Contribution result</b>	<b>177.7</b>	<b>20.8</b>	<b>(37.7)</b>	<b>5.8</b>	<b>166.6</b>	<b>96.3</b>	<b>26.1</b>	<b>(6.5)</b>	<b>115.9</b>	<b>282.5</b>
Operations and central costs					<b>(174.5)</b>				<b>(9.8)</b>	<b>(184.3)</b>
Project costs					<b>(60.0)</b>				<b>(8.8)</b>	<b>(68.8)</b>
<b>Operating result</b>					<b>(67.9)</b>				<b>97.3</b>	<b>29.4</b>
Intangible asset impairment										-
PPI provision and conduct and legal risk										<b>(38.6)</b>
Share of post tax losses from joint ventures										<b>(0.1)</b>
Financial Services Compensation Scheme Levies										<b>(25.3)</b>
Fair value amortisation										<b>(41.2)</b>
<b>Loss before taxation</b>										<b>(75.8)</b>
Income tax										<b>19.1</b>
<b>Loss for the period</b>										<b>(56.7)</b>

1. Included within 'Core - Other' is Unity Trust Bank. Unity Trust Bank operates in the corporate banking and social economy sectors and is consolidated into the Bank's results on the basis of control. On 14 January 2014, it was announced that the Bank is in discussions with the Board of Unity Trust Bank about a potential sale of its 26.7% shareholding. Discussions continue and any decision on a changed ownership structure would be subject to regulatory approval.

During 2014 the Bank changed the way it reports the Core and Non-core business costs by segment. The 2013 comparatives have been re-presented to reflect this change.

	Core				Total Core	Non-core			Total Non-core	Restated Total
	Retail	BaCB	Treasury	Other		Corporate CoAM	Optimum	Illius		
<b>Period to 30 June 2013</b>										
Net interest income	203.5	34.4	(5.7)	4.3	<b>236.5</b>	15.1	(7.5)	(3.1)	<b>4.5</b>	<b>241.0</b>
Non-interest income	65.0	7.7	26.9	0.9	<b>100.5</b>	17.1	3.3	(14.5)	<b>5.9</b>	<b>106.4</b>
<b>Operating income</b>	<b>268.5</b>	<b>42.1</b>	<b>21.2</b>	<b>5.2</b>	<b>337.0</b>	<b>32.2</b>	<b>(4.2)</b>	<b>(17.6)</b>	<b>10.4</b>	<b>347.4</b>
Direct costs	(90.4)	(11.5)	(4.8)	(3.3)	<b>(110.0)</b>	(5.5)	(1.2)	(1.9)	<b>(8.6)</b>	<b>(118.6)</b>
Impairment losses on loans and advances	(21.7)	(0.5)	(0.1)	(0.5)	<b>(22.8)</b>	(432.9)	(36.2)	-	<b>(469.1)</b>	<b>(491.9)</b>
<b>Contribution result</b>	<b>156.4</b>	<b>30.1</b>	<b>16.3</b>	<b>1.4</b>	<b>204.2</b>	<b>(406.2)</b>	<b>(41.6)</b>	<b>(19.5)</b>	<b>(467.3)</b>	<b>(263.1)</b>
Operations and central cost					<b>(169.2)</b>				<b>(19.4)</b>	<b>(188.6)</b>
Project costs					<b>(45.2)</b>				<b>(3.7)</b>	<b>(48.9)</b>
<b>Operating result</b>					<b>(10.2)</b>				<b>(490.4)</b>	<b>(500.6)</b>
Intangible asset impairment										<b>(148.4)</b>
PPI provision and conduct and legal risk										<b>(163.0)</b>
Share of post tax profits from joint ventures										<b>0.3</b>
Financial Services Compensation Scheme Levies										<b>(24.7)</b>
Fair Value Amortisation										<b>(8.2)</b>
<b>Loss before taxation</b>										<b>(844.6)</b>
Income tax										<b>39.4</b>
<b>Loss for the period</b>										<b>(805.2)</b>

<b>Reconciliation to statutory income statement</b>	<b>Period to 30 June 2014</b>	<b>Restated Period to 30 June 2013</b>
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**Net interest income**

Total interest margin for reportable segments	247.9	241.0
Interest fair value unwind	(45.0)	(4.2)
Provision for customer redress claims	(25.0)	(39.0)
<b>Net interest income</b>	<b>177.9</b>	<b>197.8</b>

**Non-interest income**

Total non-interest income for reportable segments	60.6	106.4
Interest fair value unwind	6.0	0.3
Provision for customer redress claims	(5.0)	(94.0)
<b>Non-interest income</b>	<b>61.6</b>	<b>12.7</b>

Comprising:

Net fee and commission income / (expense)	63.0	(14.0)
Net trading income	0.2	1.1
Other operating (expense) / income	(1.6)	25.6
	<b>61.6</b>	<b>12.7</b>

**Operating expenses**

Total direct costs for reportable segments	(112.7)	(118.6)
Interest fair value unwind	(2.2)	(4.3)
Operations and central costs	(184.3)	(188.6)
Project costs	(68.8)	(48.9)
Provision for customer redress claims	(8.6)	(30.0)
Financial Services Compensation Scheme Levies	(25.3)	(24.7)
Re-presentation of fraud costs	-	4.1
<b>Operating expenses</b>	<b>(401.9)</b>	<b>(411.0)</b>

**Interest fair value unwind**

Total interest unwind for reportable segments	(41.2)	(8.2)
Interest margin unwind	45.0	4.2
Non-interest income unwind	(6.0)	(0.3)
Operating expenses unwind	2.2	4.3
Interest fair value unwind	-	-

**Impairment gains/(losses) on loans and advances**

Total impairment gains/(losses) on loans and advances for reportable segments	86.7	(491.9)
Re-presentation of fraud costs	-	(4.1)
<b>Impairment gains/(losses) on loans and advances</b>	<b>86.7</b>	<b>(496.0)</b>

The 2013 comparatives have been restated as described in note 3.

They have also been re-presented in respect of costs, including fraud costs, to reflect the way these are now managed and reported within the Bank.

**30 June 2014**

	Core				Total Core	Non-core			Total Non-core	Total
	Retail	BaCB	Treasury	Other		Corporate CoAM	Optimum	Illius		
<b>Segment assets</b>	15,335.5	778.8	10,892.7	495.0	<b>27,502.0</b>	4,867.9	7,117.4	156.0	<b>12,141.3</b>	<b>39,643.3</b>
<b>Unallocated assets</b>										<b>1,151.9</b>
<b>Total assets for reportable segments</b>										<b>40,795.2</b>
<b>Statutory adjustments</b>										<b>281.4</b>
<b>Bank total assets</b>										<b>41,076.6</b>

	Core				Total Core	Non-core			Total Non-core	Total
	Retail	BaCB	Treasury	Other		Corporate CoAM	Optimum	Illius		

<b>Segment liabilities</b>	27,249.1	2,594.6	6,438.5	448.0	<b>36,730.2</b>	809.3	-	-	<b>809.3</b>	<b>37,539.5</b>
<b>Unallocated liabilities</b>										<b>807.9</b>
<b>Total liabilities for reportable segments</b>										<b>38,347.4</b>
<b>Statutory adjustments</b>										<b>614.0</b>
<b>Bank total liabilities</b>										<b>38,961.4</b>

### 31 December 2013 (as restated)

	Core				Total Core	Non-core			Total Non-core	Total
	Retail	BaCB	Treasury	Other		Corporate CoAM	Optimum	Illius		
Segment assets	16,790.9	844.9	10,491.4	441.0	<b>28,568.2</b>	5,646.1	7,326.1	162.2	<b>13,134.4</b>	<b>41,702.6</b>
Unallocated assets										1,557.9
Total assets for reportable segments										43,260.5
Statutory adjustments										136.8
<b>Bank total assets</b>										<b>43,397.3</b>

	Core				Total Core	Non-core			Total Non-Restated core	Total
	Retail	BaCB	Treasury	Other		Corporate CoAM	Optimum	Illius		
Segment liabilities	27,899.3	3,479.0	7,645.5	394.9	<b>39,418.7</b>	831.0	-	-	<b>831.0</b>	<b>40,249.7</b>
Unallocated liabilities										603.8
Total liabilities for reportable segments										40,853.5
Statutory adjustments										751.3
<b>Bank total liabilities</b>										<b>41,604.8</b>

Unallocated assets are non-customer assets and liabilities that are not allocated to a particular segment.

Statutory adjustments mainly relate to the reallocation of provisions, accruals and prepayments and the gross up of mark to market values.

The 2013 comparatives have been restated as described in note 3.

## 5. Net interest income

	Period to 30 June 2014	Restated Period to 30 June 2013
<b>Interest receivable and similar income</b>		
On financial assets not at fair value through income or expense:		
On loans and advances to customers	567.9	643.1
On loans and advances to banks	17.2	15.4
On investment securities	29.6	75.3
	<b>614.7</b>	733.8
On financial assets at fair value through income or expense:		
Net interest expense on financial instruments hedging assets	(54.9)	(67.4)
Net interest income on financial instruments not in a hedging relationship	6.5	41.2
	<b>566.3</b>	707.6

Included within interest receivable is £3.9m (30 June 2013: £7.2m) relating to profit on sale of investment securities - available for sale.

The changes in provision for potential customer redress claims recorded against interest income consist of:

	Period to 30 June 2014	Period to 30 June 2013
Potential customer redress in relation to breaches of the Consumer Credit Act	(29.0)	(29.0)



Potential customer redress in relation to past sales of interest rate hedging products	-	(10.0)
Provision for potential customer redress and other costs in relation to mortgage documentation	4.0	-
	(25.0)	(39.0)

See note 13 for further details of the above provisions.

	Period to 30 June 2014	Period to 30 June 2013
<b>Interest expense and similar charges</b>		
On financial liabilities not at fair value through income or expense:		
On customer accounts	(214.6)	(255.3)
On bank and other deposits	(118.8)	(127.5)
On subordinated liabilities	(11.3)	(40.1)
On perpetual secured debt	-	(20.8)
	(344.7)	(443.7)
On financial liabilities at fair value through income or expense:		
Net interest expense on financial instruments hedging liabilities	(8.4)	(9.5)
Net interest expense on financial instruments not in a hedging relationship	(10.3)	(17.6)
	(363.4)	(470.8)
<b>Net interest income</b>	<b>177.9</b>	<b>197.8</b>

The 2013 comparatives have been restated as described in note 3.

The Bank's perpetual secured debt was extinguished on 20 December 2013 as part of the Liability Management Exercise. The associated interest expense is therefore £nil during the period (30 June 2013: £20.8m).

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 £53.8m (30 June 2013: £44.7m). Further details of which are provided in note 19.

## 6. Net fee and commission income / (expense)

	Period to 30 June 2014	Period to 30 June 2013
<b>Fee and commission income</b>		
On items not at fair value through income or expense	104.8	116.0
On trust or fiduciary activities that result from holding or investing in assets on behalf of others	0.1	0.2
	104.9	116.2

The changes in provision for potential customer redress claims recorded against net fee and commission income consist of:

	Period to 30 June 2014	Period to 30 June 2013
Potential customer redress in relation to past sales of Payment Protection Insurance	(5.0)	(53.0)
Potential customer redress in relation to alleged failings in the introduction of third party sales of card and identity protection products	-	(26.0)
Potential customer redress in relation to mortgage arrears fees and charges	-	(15.0)
	(5.0)	(94.0)

See note 13 for further details of the above provisions.

	Period to 30 June 2014	Period to 30 June 2013
<b>Fee and commission expense</b>		
On items not at fair value through income or expense	(36.8)	(34.3)
On items at fair value through income or expense	(0.1)	(1.9)
	(36.9)	(36.2)
<b>Net fee and commission income / (expense)</b>	<b>63.0</b>	<b>(14.0)</b>

## 7. Operating expenses

		Restated
	Period to 30 June	Period to 30 June
	Note	2014
		2013
<b>Operating expense</b>		
Staff costs	8	146.5
Administrative expenses		131.5
Depreciation of property, plant and equipment		146.9
Amortisation of intangible fixed assets		7.0
Impairment of brand intangible fixed assets		8.8
Operating lease rentals		12.9
Financial Services Compensation Scheme Levies	13	-
Property provisions for liabilities and charges provided in the period	13	15.6
Property provisions for liabilities and charges released during the period	13	24.7
Other provisions for liabilities and charges provided in the period	13	1.9
Other provisions for liabilities and charges released during the period	13	3.6
Direct expenses from investment properties that generated rental income in the period		-
Direct expenses from investment properties that did not generate rental income in the period	13	2.7
		(0.1)
		4.0
		1.7
		0.1
		0.1
		<b>359.0</b>
		<b>346.4</b>

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

		Period to 30 June
	Note	2014
		2013
Investment costs		20.6
Bank separation costs	13	14.7
Provision for customer redress claims relating to processing of first payments on certain mortgages and other redress claims	13	6.7
Costs incurred in bid for Lloyds Banking Group branches		-
Impairment of property, plant and equipment		30.0
		-
		7.0
		9.9
		<b>42.9</b>
		<b>64.6</b>
<b>Total operating expenses</b>		<b>401.9</b>
		<b>411.0</b>

No expenditure has been incurred in respect of the Government's Bank Levy since the relevant aggregate liabilities of the Bank are below the qualifying threshold.

The 2013 comparatives have been restated as described in note 3.

## 8. Staff costs

		Period to 30 June
	Note	June 2014
		2013
Wages and salaries		88.5
Social security costs		93.7
Pension costs:		7.7
Defined benefit plans	15	3.3
Defined contribution plans		13.8
Other staff costs		16.9
		<b>33.2</b>
		<b>146.5</b>
		<b>131.5</b>

Up until 20 December 2013, employee activities were undertaken across the Co-operative Banking Group and the figures above reflect the Bank's share of these services.

Employees of the Bank were employed by CFS Management Services Limited (CFSMS) during 2013 and staff costs recharged to the Bank. With effect from 23 January 2014, the majority of Bank employees had their employment contracts transferred from CFSMS to The Co-operative Bank plc. The transfer was required to support the legal separation of the Bank from the Co-operative Group. This transfer took place under the Transfer of Undertakings (Protection of Employment) Regulations 2006.

## 9. Income tax

	Note	Period to 30 June 2014	Restated Period to 30 June 2013
<b>Current tax</b>			
Current period		(5.3)	(103.1)
Prior period		1.5	-
<b>Total current tax</b>		<b>(3.8)</b>	<b>(103.1)</b>
<b>Deferred tax</b>			
Current period	14	(15.3)	7.6
Write off of prior period deferred tax asset	14	-	56.1
<b>Total deferred tax</b>		<b>(15.3)</b>	<b>63.7</b>
<b>Total tax credit</b>		<b>(19.1)</b>	<b>(39.4)</b>

In addition to the above, current tax of £1.2m has been charged to other comprehensive income and deferred tax of £0.1m has been credited to other comprehensive income.

Further information on deferred income tax is presented in note 14. 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:

	Note	Period to 30 June 2014	Restated Period to 30 June 2013
Loss before taxation		(75.8)	(844.6)
Tax calculated at a rate of 21.49% (30 June 2013: 23.25%)		(16.3)	(196.4)
Effects of:			
Write off of prior year deferred tax asset	14	-	56.1
Non-taxable income		(1.3)	(0.7)
Unrecognised deferred tax		(0.4)	92.9
Discount of group relief debtor		(4.9)	-
Change in rate of deferred tax		0.5	2.1
Expenses not deductible for tax purposes		2.4	2.9
Adjustments to tax charge in respect of prior periods		1.5	-
Depreciation of capital expenditure qualifying for capital allowances		0.2	2.9
Other differences		(0.8)	0.8
		<b>(19.1)</b>	<b>(39.4)</b>

Expenses not deductible of £2.4m (30 June 2013: £2.9m) include costs resulting from the separation of the Bank from the Co-operative Group.

The comparatives for period 30 June 2013 have been restated for the FSCS levy provision and hedge accounting changes as described in note 3. This results in additional unrecognised deferred tax of £6.7m.

## 10. a) Loans and advances to customers

	30 June 2014	31 December 2013
Gross loans and advances	28,598.2	31,274.6
Less: allowance for losses	(761.8)	(952.4)
	<b>27,836.4</b>	<b>30,322.2</b>

The Bank's loans and advances to customers include £167.6m (31 December 2013: £134.2m) of financial assets at fair value through income or expense designated at initial recognition to eliminate or significantly reduce a measurement or recognition inconsistency. Of these, £86.9m (31 December 2013: £62.9m) are secured by real estate collateral.

Loans and advances to customers include £9,515.9m (31 December 2013: £10,111.9m) 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. Included within the Bank's deposits by banks are £500.2m (31 December 2013: £500.3m) of loans from external third parties and within the Bank's debt securities in issue are £3,338.9m (31 December 2013: £3,703.4m) of fixed and floating rate notes, all secured on these mortgage assets.

### Concentration of exposure

The Bank's exposure is virtually all 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		Total
	Individual	Collective	Individual	Collective	
<b>Period to 30 June 2014</b>					
At the beginning of the period	10.7	167.8	724.5	49.4	952.4
Balances with debt collection agencies	-	39.6	-	-	39.6
Charge/(release) against profits	(0.3)	1.9	(109.1)	(11.4)	(118.9)
Amounts written off	(1.8)	(8.9)	(93.9)	-	(104.6)
Unwind of discount allowance	(0.1)	(2.4)	(4.2)	-	(6.7)
At the end of the period	8.5	198.0	517.3	38.0	761.8

Core provisions are analysed in further detail below:

	Core						Total Core
	Retail		BaCB		Other <sup>(1)</sup>		
	Individual	Collective	Individual	Collective	Individual	Collective	
<b>Period to 30 June 2014</b>							
At the beginning of the period	2.8	161.9	0.5	5.3	7.4	0.6	178.5
Balances with debt collection agencies	-	39.6	-	-	-	-	39.6
Charge/(release) against profits	0.3	1.2	0.5	0.8	(1.1)	(0.1)	1.6
Amounts written off	(0.3)	(8.9)	(0.1)	-	(1.4)	-	(10.7)
Unwind of discount allowance	-	(2.4)	-	-	(0.1)	-	(2.5)
At the end of the period	2.8	191.4	0.9	6.1	4.8	0.5	206.5

Non-core provisions are analysed in further detail below:

	Non-core				Total Non-core
	Corporate		Optimum		
	Individual	Collective	Individual	Collective	
<b>Period to 30 June 2014</b>					
At the beginning of the period	698.4	40.0	26.1	9.4	773.9
Charge/(release) against profits	(98.2)	(13.1)	(10.9)	1.7	(120.5)
Amounts written off	(91.7)	-	(2.2)	-	(93.9)
Unwind of discount allowance	(4.2)	-	-	-	(4.2)
At the end of the period	504.3	26.9	13.0	11.1	555.3

	Core		Non-core		Total
	Individual	Collective	Individual	Collective	
<b>Year to 31 December 2013</b>					
At the beginning of the year	9.4	175.2	434.8	23.6	643.0
Charge against profits for the period to 30 June 2013	2.9	34.3	402.1	117.9	557.2
Charge/(release) against profits for the period to 31 December 2013	(0.5)	3.7	39.2	(92.1)	(49.7)
Amounts written off	(0.9)	(41.8)	(145.1)	-	(187.8)
Unwind of discount allowance	(0.2)	(3.6)	(6.9)	-	(10.7)
Interest charged on impaired loans	-	-	0.4	-	0.4
At the end of the year	10.7	167.8	724.5	49.4	952.4

Core provisions are analysed in further detail below:

	Core						Total Core
	Retail		BaCB		Other <sup>(1)</sup>		
	Individual	Collective	Individual	Collective	Individual	Collective	
<b>Year to 31 December 2013</b>							
At the beginning of the year	2.7	173.3	0.3	1.1	6.4	0.8	184.6
Charge against profits for the period to 30 June 2013	1.9	33.7	0.4	0.6	0.6	-	37.2
Charge/(release) against profits for the period to 31 December 2013	(1.3)	(0.8)	0.2	4.7	0.6	(0.2)	3.2
Amounts written off	(0.5)	(40.7)	(0.4)	(1.1)	-	-	(42.7)
Unwind of discount allowance	-	(3.6)	-	-	(0.2)	-	(3.8)
At the end of the year	2.8	161.9	0.5	5.3	7.4	0.6	178.5

Non-core provisions are analysed in further detail below:

	Non-core				Total Non-core
	Corporate		Optimum		
	Individual	Collective	Individual	Collective	
<b>Year to 31 December 2013</b>					
At the beginning of the year	426.9	20.5	7.9	3.1	458.4
Charge against profits for the period to 30 June 2013	407.4	49.4	(5.3)	68.5	520.0
Charge against profits for the period to 31 December 2013	10.4	(29.9)	28.8	(62.2)	(52.9)
Amounts written off	(139.8)	-	(5.3)	-	(145.1)
Unwind of discount allowance	(6.9)	-	-	-	(6.9)
Interest charged on impaired loans	0.4	-	-	-	0.4
At the end of the year	698.4	40.0	26.1	9.4	773.9

1. 'Core - Other' relates to Unity Trust Bank.

A review of the Bank's relationships with debt collection agencies in 2014 concluded that the Bank had substantially retained all the risks and rewards associated with such relationships. The related gross receivables of £41.4m and associated allowance of £39.6m have therefore been recognised as at 30 June 2014. The comparative information has not been adjusted on the grounds of materiality. Had the comparative information been adjusted the net Loans and Advances to Customers balance and Total Equity would have increased by £1.8m and £1.8m respectively.

The net impairment credit in the Bank's income statement is £86.7m (30 June 2013: loss of £496.0m). This includes amounts recovered by the Bank of £0.4m (30 June 2013: £0.2m) against amounts previously written off.

The impairment charge also includes a provision of £32.6m (30 June 2013: £1.4m) made against fair value adjustments for hedged risk during the period (as shown in the fair value adjustments for hedged risk tables).

The overall write back of impairment is largely due to improved credit conditions, restructuring of assets, and the disposal of Non-core assets at favourable prices, as part of the Bank's strategy to exit these books.

#### 10. b) Fair value adjustments for hedged risk

The Bank has entered into interest rate swaps that protect it from changes in interest rates on the floating rate liabilities that fund its portfolio of fixed rate mortgages. Changes in the fair values of these swaps are offset by changes in the fair values of the fixed rate mortgages.

	30 June 2014	Restated 31 December 2013
Gross fair value adjustments for hedged risk	137.4	153.1
Less: impairment provision	(79.4)	(46.8)
	58.0	106.3

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

	30 June 2014	31 December 2013
At the beginning of the period	46.8	37.0

Charge against profits for the period to 30 June 2014 (30 June 2013)	32.6	1.4
Charge against profits for the period to 31 December 2013	-	8.4
At the end of the period	79.4	46.8

The 2013 comparatives have been restated as described in note 3.

## 11. Investment securities

### a) Loans and receivables

	30 June 2014	31 December 2013
Loans and receivables		
Listed	16.0	23.6
Unlisted	-	-
	16.0	23.6
Less: allowance for losses	-	-
	16.0	23.6

### b) Available for sale

	30 June 2014	31 December 2013
Available for sale		
Listed	2,729.9	2,497.2
Unlisted	195.3	255.2
	2,925.2	2,752.4
Less: allowance for losses	-	(20.0)
	2,925.2	2,732.4
Included in cash and cash equivalents	155.0	105.0

### Impairment analysis of investment securities - available for sale

	30 June 2014	31 December 2013
At the beginning of the period	20.0	39.0
Release for the period	(1.1)	-
Utilised during the period	(18.9)	(18.5)
Exchange adjustments	-	(0.5)
At the end of the period	-	20.0

A number of securities that had previously been fully provided for were sold during the period. Cash proceeds of £1.1m were received, resulting in a £1.1m release of the provision and utilisation of the remaining £18.9m.

### c) Fair value through income or expense

	30 June 2014	31 December 2013
Fair value through income or expense		
Listed	1,256.7	1,743.4
	1,256.7	1,743.4

### d) Analysis of investment securities by issuer

	30 June 2014	31 December 2013
Investment securities issued by public bodies:		
Government securities	3,021.1	3,064.3
Other public sector securities	255.2	580.5
	3,276.3	3,644.8

Investment securities issued by other issuers:

Bank and building society certificates of deposits	195.3	235.2
<hr/>		
Other debt securities:		
Other floating rate notes	710.3	595.8
Mortgage backed securities	16.0	23.6
	<b>726.3</b>	<b>619.4</b>
	<b>4,197.9</b>	<b>4,499.4</b>

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

## 12. Customer accounts - capital bonds

	<b>30 June 2014</b>	31 December 2013
<hr/>		
Retail	<b>388.9</b>	538.1

Capital bonds are fixed term customer accounts with returns based on the movement in an index (eg FTSE100) over the term of the bond.

The capital bonds have been designated on initial recognition at fair value through income and expense and are carried at fair value.

The fair values for the capital bonds are obtained on a monthly basis from the swap counterparties. These external valuations are reviewed independently using valuation software to ensure the fair values are priced on a consistent basis.

The maximum amount the Bank would contractually be required to pay at maturity for all the capital bonds is £394.9m (31 December 2013: £539.2m).

The Bank uses swaps to create economic hedges against all of its capital bonds. The gain on capital bonds in the income statement for the period is £23.6m (30 June 2013: loss of £9.4m). However, taking into account changes in fair value of the associated swaps, the net impact to the income statement for the period is a loss of £0.3m (30 June 2013: gain of £0.3m).

## 13. Provisions for liabilities and charges

### Period to 30 June 2014

	Note	Property	FSCS levies	PPI	Conduct/ legal	Other	Total
At the beginning of the period		23.1	13.3	133.8	304.6	74.9	549.7
Provided / (released) in the period:							
- net interest income	5	-	-	-	25.0	-	25.0
- net fee and commission income	6	-	-	5.0	-	1.0	6.0
- operating expense	7	1.9	25.3	-	-	2.1	29.3
- operating expense - separation costs	7	-	-	-	-	6.7	6.7
- operating expense - other potential customer redress claims	7	-	-	-	8.6	-	8.6
Utilised during the period		<b>(0.9)</b>	-	<b>(42.3)</b>	<b>(10.5)</b>	<b>(26.8)</b>	<b>(80.5)</b>
<b>At the end of the period</b>		<b>24.1</b>	<b>38.6</b>	<b>96.5</b>	<b>327.7</b>	<b>57.9</b>	<b>544.8</b>

Provisions were analysed as follows:

Amounts falling due within one year	12.3	25.4	80.5	310.7	57.9	486.8
Amounts falling due after one year	11.8	13.2	16.0	17.0	-	58.0
	<b>24.1</b>	<b>38.6</b>	<b>96.5</b>	<b>327.7</b>	<b>57.9</b>	<b>544.8</b>

### Year to 31 December 2013

	Note	Property	FSCS levies	PPI	Conduct/ legal	Other	Total
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At the beginning of the year (as restated)	7.3	13.8	116.0	0.2	0.6	137.9
Provided / (released) in the period:						
- net interest income	5	-	-	194.5	-	194.5
- net fee and commission income	6	-	103.0	82.1	-	185.1
- operating expense (as restated)	7	16.3	24.1	-	35.0	75.4
- operating expense - separation costs	7	-	-	-	39.4	39.4
- operating expense - other potential customer redress claims	7	-	-	31.9	-	31.9
Utilised during the year	(0.5)	(24.6)	(85.2)	(4.1)	(0.1)	(114.5)
At the end of the year (as restated)	23.1	13.3	133.8	304.6	74.9	549.7

Provisions were analysed as follows:

Amounts falling due within one year	10.2	13.3	113.8	304.6	74.9	516.8
Amounts falling due after one year	12.9	-	20.0	-	-	32.9
	23.1	13.3	133.8	304.6	74.9	549.7

Conduct and legal provisions of £25.0m (period to 30 June 2013: £39.0m) have been recorded as a charge against interest in the income statement. Details of these amounts are provided in the next section.

The Directors consider conduct and legal provisions a critical accounting judgement. Further details are provided in note 2.

The 2013 comparatives for FSCS levies have been restated as described in note 3.

## 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 using a discount rate of 3.5%. 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 at 31 December 2012, the Bank has an obligation to pay levies in respect of the interest cost for 2013/14. From this scheme year, the FSCS had also started to repay the principal of the Treasury loans and a further levy had been raised in 2013/14 for the expected capital shortfall for these loans, so that they are fully repaid by March 2016. The total levy to be raised is £961m over three years, with the first instalment of £363m collected in the previous year.

The Bank has provided £38.6m as at 30 June 2014 (2013 restated: £13.3m) for its share of the levies raised by the FSCS. The provision includes £14.3m in respect of the 2013/14 interest levy and £13.1m for the 2014/15 interest levy. 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. The Bank has also provided £11.2m in respect of its share of the capital levy.

## 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.



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 £5.0m (30 June 2013: £53.0m) has been recognised in the period (note 6), in respect of the total expected cost to the Bank of carrying out this work and paying compensation, making total provisions raised of £352.0m (31 December 2013: £347.0m). This is discussed in more detail in note 2.

#### Conduct/legal provisions

During the period £25.0m (30 June 2013: £39.0m) was charged to net interest income. This consists of: potential customer redress following identification of breaches of the highly technical requirements of the Consumer Credit Act £29.0m (30 June 2013: £29.0m); potential interest rate swap mis-selling £nil (30 June 2013: £10.0m); and potential customer redress and other costs in relation to mortgage documentation £4.0m release (30 June 2013: £nil).

£8.6m (30 June 2013: £30.0m) was charged through operating expenses relating to potential customer redress for the processing of first payments on certain mortgages.

#### Other

£6.7m (30 June 2013: £nil) has been provided through operating expenses for additional costs associated with the separation of the Bank from the Co-operative Group.

#### 14. Deferred tax

Deferred taxes are calculated on all temporary differences under the liability method using a tax rate of 20% (2013: 20%).

The movements on the deferred tax accounts are as follows:

	30 June 2014			31 December 2013 (restated)			
	Note	Deferred tax asset	Deferred tax liability	Total	Deferred tax asset	Deferred tax liability	Total
Deferred tax at the beginning of the period		2.5	(92.5)	(90.0)	159.6	(121.4)	38.2
Credited/(charged) to the income statement:							
Current period		0.6	14.7	15.3	(20.4)	28.9	8.5
Write off of prior period deferred tax asset	9	-	-	-	(157.5)	-	(157.5)
Prior period		-	-	-	3.3	-	3.3
		0.6	14.7	15.3	(174.6)	28.9	(145.7)
Credited/(charged) to other comprehensive income:							
Cashflow hedges		0.1	-	0.1	17.4	-	17.4
Available for sale		-	-	-	0.1	-	0.1
		0.1	-	0.1	17.5	-	17.5
<b>Deferred tax at the end of the period</b>		<b>3.2</b>	<b>(77.8)</b>	<b>(74.6)</b>	<b>2.5</b>	<b>(92.5)</b>	<b>(90.0)</b>

The deferred tax asset above includes an offset for those deferred tax liabilities that are permissible to be offset.

	30 June 2014		31 December 2013 (restated)	
	Deferred tax asset	Deferred tax liability	Deferred tax asset	Deferred tax liability
Deferred tax comprises:				
Capital allowances on fixed assets and assets leased to customers	2.2	-	6.6	-
Fair value adjustments - The Co-operative Bank plc	-	-	-	-
Fair value adjustments - The Co-operative Bank subsidiaries	-	(82.6)	-	(92.5)
Other temporary differences	3.2	4.8	2.5	-
Tax losses carried forward	-	-	-	-
Pensions and other post-retirement benefits	-	-	-	-
Cashflow hedges	(1.6)	-	(0.8)	-

Unrealised appreciation on investments	(0.6)	-	(0.6)	-
FSCS levy provision	-	-	(5.2)	-
	<b>3.2</b>	<b>(77.8)</b>	2.5	(92.5)

Net deferred tax assets expected to be recoverable after one year are £3.2m (30 June 2013: £103.5m, 31 December 2013: £2.5m restated).

Other temporary differences for the Bank totalling £8.0m (30 June 2013: £27.0m, 31 December 2013: £2.5m restated) relate to temporary differences arising on consolidation adjustments and the taxation of special purpose entities under the securitisation regime.

The Directors consider the recoverability of deferred tax to be a critical accounting judgement. Further detail is provided in note 2.

The deferred tax charge/(credit) in the income statement comprises:

	Period to 30 June 2014	Restated Period to 30 June 2013
Capital allowances on fixed assets and assets leased to customers	4.4	(0.1)
Fair value adjustments	(9.9)	8.6
Other temporary differences	(9.8)	(0.9)
Write off of prior year deferred tax asset	-	56.1
	<b>(15.3)</b>	63.7

Deferred tax assets totalling £270.1m (31 December 2013: £270.5m restated) have not been recognised where doubt exists over the availability of sufficient future taxable profits. Deferred tax assets from the prior year of £nil (31 December 2013: £157.5m) have been written off in the period. Deferred tax assets of £0.4m (31 December 2013: £113.9m) in respect of the current period have not been recognised.

Reductions in the UK corporation tax rate from 23% to 21% (effective from 1 April 2014) and 20% (effective from 1 April 2015) were substantively enacted on 2 July 2013. This will reduce the Bank's future current tax charge accordingly. The deferred tax liabilities at 30 June 2014 have been calculated based on the rate of 20% substantively enacted at the balance sheet date.

## 15. Pensions

The Bank participates in two hybrid multi-employer pension schemes, consisting of defined benefit and defined contribution sections, and also operates a small unfunded scheme; only the Pace scheme is open to further contributions. Full details of the schemes are disclosed within the Bank's Annual Report and Accounts 2013.

### The Co-operative Pension Scheme (Pace)

The Bank continues to account for this multi-employer scheme on a defined contribution basis as detailed within the Bank's Annual Report and Accounts 2013. 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 £104m.

### Britannia Pension Scheme

The Bank accounted for the Britannia Pension Scheme ("the Britannia Scheme") on a defined contribution basis in the Bank's Annual Report and Accounts 2013 for the reasons explained therein. Following increased separation of the Bank from the wider Co-operative Group, the Britannia Scheme is now accounted for on a defined benefit basis in the Interim Financial Report 2014.

Whilst the Britannia Scheme is in accounting surplus, this has not been recognised on the Balance Sheet in accordance with IFRIC 14. The Bank has however recognised a £3.2m liability (31 December 2013 – unrecognised £3.1m) in relation to the unfunded element of the Britannia Scheme.

The pension scheme liabilities on the balance sheet comprise:

	Assets 30 June 2014	Assets not recognised 31 December 2013	Liabilities 30 June 2014	Liabilities not recognised 31 December 2013	Net 30 June 2014	Net not recognised 31 December 2013
Britannia Pension Scheme	637.9	630.7	(610.8)	(604.2)	27.1	26.5
Less asset limitation (IFRIC 14)	(27.1)	(26.5)	-	-	(27.1)	(26.5)
	610.8	604.2	(610.8)	(604.2)	-	-

Britannia unfunded obligations	-	-	(3.2)	(3.1)	(3.2)	(3.1)
	<u>610.8</u>	<u>604.2</u>	<u>(614.0)</u>	<u>(607.3)</u>	<u>(3.2)</u>	<u>(3.1)</u>

The amounts recorded in the balance sheet are as follows:

	<b>30 June 2014</b>	<b>Not recognised 31 December 2013</b>
Present value of funded obligations	(610.8)	(604.2)
Present value of unfunded obligations	(3.2)	(3.1)
Asset limitation (IFRIC 14)	(27.1)	(26.5)
Fair value of plan assets	<u>637.9</u>	<u>630.7</u>
Net retirement plan liability	<u>(3.2)</u>	<u>(3.1)</u>

The amounts recognised in the income statement are as follows:

	<b>30 June 2014</b>	<b>Not recognised 31 December 2013</b>
Current service cost	-	-
Interest expense on Defined Benefit Obligation	(13.6)	(26.6)
Interest income on plan assets	14.2	26.7
Administrative expenses and taxes	<u>(0.5)</u>	<u>(1.1)</u>
	<u>0.1</u>	<u>(1.0)</u>

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

31 December 2013 - Not recognised	(604.2)
Benefit payments from plan	7.0
Changes in asset ceiling/onerous liability	<u>(13.6)</u>
<b>30 June 2014</b>	<u><u>(610.8)</u></u>

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

31 December 2013 - Not recognised	630.7
Interest income	14.2
Contributions by the employer	0.5
Benefit payments from plan	(7.0)
Administrative expenses paid from plan assets	<u>(0.5)</u>
<b>30 June 2014</b>	<u><u>637.9</u></u>

The statutory deadline for the 5 April 2014 Britannia Scheme triennial valuation is 5 July 2015.

## 16. Contingent liabilities and commitments

Details of contingent liabilities and commitments at December 2013 were disclosed in the 2013 Annual Report and Accounts. These included the following key areas: CFSMS indemnification agreement; conduct and Consumer Credit Act issues; regulatory and other investigations; legal proceedings; mortgage securitisation representations and warranties; pensions and tax treatment of Bank separation.

The items disclosed remain broadly unchanged, except in the following key areas:

### Breaches of the technical requirements of the Consumer Credit Act

An amount of £138.5m (2013: £109.5m) has been recognised to refund interest following identification of a number of breaches of the highly technical requirements of the Consumer Credit Act. As part of this process of identification, detailed and technical legal analysis has been carried out to determine whether breaches of the technical requirements have in fact occurred, the nature of those breaches and the consequences which follow (which differ according to the precise nature of the breach). Such legal analysis by its nature involves judgement and assessment of the facts of particular circumstances. In the event that such legal analysis and judgements are determined to be wrong, the Bank could be exposed to a material additional liability. The amount of £138.5m which has been provided is the best estimate of the liability based on the legal analysis.

## **17. Related party transactions**

Related party transactions and transactions with key management personnel in the half year to 30 June 2014 are similar in nature to those for the year ended 31 December 2013. Details of these transactions can be found in the 2013 Annual Report and Accounts.

Significant changes to those relationships and transactions from December 2013 are as follows:

### **Parent, subsidiary and ultimate controlling party**

As at 31 December 2013 the Bank was an associate of, and therefore a related party of the Co-operative Group as the Co-operative Group owned 30% of the Bank's ordinary shares, had Bank Board representation and there were material transactions between the two companies.

On 30 May 2014 there was a further £400m share capital issuance to existing investors. This resulted in the Co-operative Group ownership reducing to 20% of the ordinary share capital of the Bank.

At 30 June 2014, due to the Co-operative Group's ownership of 20% of the Bank's ordinary shares and the material transactions between the two companies, the Bank is deemed an associate of, and therefore a related party of, the Co-operative Group.

Details of the Relationship Agreement, Co-existence Principles and 2014 Commitment Agreement can be found in the 2013 Annual Report and Accounts.

### **Variation and Director appointment deed**

At the time of the Capital Raising in May 2014, the Bank, the Co-operative Group Limited and the Co-operative Banking Group entered into a Variation and Director Appointment Deed which provided that the Co-operative Group Limited would have a right, for so long as it remains a bona fide co-operative society and directly or indirectly controls 15% or more of the voting rights exercisable at general meetings of the Bank, to appoint one Director to the Board.

This Deed also makes certain amendments to the Relationship Agreement by deleting the provision whereby the Co-operative Group had agreed to provide the Company with reasonable assistance to obtain a listing on the premium segment of the Official List within 12 months following the Liability Management Exercise becoming unconditional and the lock-up restrictions on the Co-operative Group disposing of its Ordinary Shares in the Bank for five years from the effective date of the Liability Management Exercise. This Variation and Director Appointment Deed provides that if the Relationship Agreement has not previously terminated in accordance with its terms with effect from 30 September 2014, these lock-up restrictions shall cease to have effect and the Co-operative Group shall from that date be entitled to sell its interest in Ordinary Shares without the consent of the Bank, provided that the Co-operative Group shall pay or cause to be paid to the Bank following such sale the net proceeds of such sale, and such payment obligation shall continue until the Undertaking to Pay (as defined in the 2014 Commitment Agreement) has been discharged in full.

### **Shareholder rights agreement**

At the time of the Capital Raising in May 2014, the Bank entered into a Shareholder Rights Agreement with four of its major shareholders being SP Coop Investment, Ltd (Cayman)("Silverpoint"), Perry Capital UK LLP ("Perry"), Invesco Asset Management Limited and York Capital Management Europe (UK) Advisors LLP (together the "Committed Shareholders") and the Co-operative Group.

Under the Shareholder Rights Agreement, the Bank has granted to each of Silver Point and Perry the right to nominate a Director for appointment to the Board for so long as Silver Point and Perry, as the case may be, directly or indirectly controls 5% or more of the voting rights exercisable at general meetings of the Bank. Such rights are not transferable, save that they will automatically transfer and be exercisable by another Committed Shareholder if Silver Point or Perry ceases to control such level of voting rights in the Bank, provided that such other Committed Shareholder itself directly or indirectly controls 5% or more of such voting rights.

The Directors appointed under the Shareholder Rights Agreement may be, but are not required to be, independent. Under the Shareholder Rights Agreement, the Bank has agreed to establish a sub-committee of the Board that will assess the feasibility of the Bank listing its ordinary shares on the Official List and make recommendations to the Board with regards to the timing of such a listing. That subcommittee will be comprised of four Directors, being one Director appointed pursuant to the Relationship Agreement, one Director appointed pursuant to the Shareholder Rights Agreement, one executive Director and one independent non-executive Director who is not a Director appointed pursuant to the Relationship Agreement or the Shareholder Rights Agreement.

In addition, any of the Committed Shareholders and the Co-operative Group who together hold 25 per cent. or more of the Bank's issued Ordinary Share capital, will have the right, not to be exercised before 30 September 2014, to require the Bank to assist in the launch of a secondary offering of Ordinary Shares, provided that the exercising Shareholders have committed to sell Ordinary Shares valued at not less than £100 million. The Committed Shareholders may only exercise this right once in any 12 month period and three times in total.

More information on both the Variation and Director Appointment Deed and the Shareholder Rights Agreement can be found in the circular for the capital raising in May 2014 at <http://www.co-operativebank.co.uk/assets/pdf/bank/news/placing-and-open-offer-circular.pdf>

## Intra-group Loan

As detailed in the 2013 Annual Report and Accounts, the Bank, the Co-operative Banking Group and the Co-operative Group entered into an intra-group loan facility. Under this agreement, the Co-operative Group will make available to the Co-operative Banking Group during 2014 a term loan facility of up to £313m. This will be utilised to support the Co-operative Banking Group's undertaking to pay the Bank the 2014 capital commitment agreed as part of the December 2013 Liability Management Exercise. During the period, the Bank has received £150m in line with the 2014 Commitment Agreement.

The Co-operative Banking Group has assigned to the Bank its rights against the Co-operative Group in the event that the Co-operative Group fails to provide the Co-operative Banking Group with a loan. A security assignment in respect of the Insurance Proceeds has been entered into between the Co-operative Banking Group and the Co-operative Group as security trustee for itself and the Bank to secure the Co-operative Banking Group's Undertaking to Pay and the Co-operative Banking Group's obligations as borrower under the Intra-group Loan.

## Pensions undertaking

As detailed in the 2013 Annual Report and Accounts, the Bank and the Co-operative Group have entered into an undertaking, whereby the Bank is not required to cease to participate in Pace. The parties, at the request of one of the parties, have entered into good faith discussions to reach agreement on the separation of Pace and agree the Bank's proportion of employer contributions in Pace (and if not agreed, the matter will be referred to an independent third party). These discussions are ongoing.

## CFSMS transactions

Details of the CFSMS-Bank 2006 services agreement were disclosed in the 2013 Annual Report and Accounts along with the fact that the Bank and CFSMS were negotiating to replace the CFSMS-Bank 2006 Agreement with appropriate arm's length revised arrangements.

It is not now planned that this agreement will be replaced by an arm's length framework agreement until the position on CFSMS pensions liabilities in respect of Bank employees is finalised. Accordingly, the CFSMS-Bank 2006 services agreement will continue, under its terms, in the meantime.

## CFSMS employees

The employment contracts of the majority of CFSMS employees who performed services to the Bank have been transferred during the first half of 2014, with a small number remaining employed by CFSMS.

## Tangible and intangible assets

A number of assets were originally purchased by CFSMS using funds advanced by the Bank and then provided to the Bank by CFSMS under the 2006 CFSMS-Bank services agreement referred to above. In 2013 the Directors of the Bank concluded that these assets met the accounting criteria to be shown as assets for the Bank and therefore reported them on the balance sheet. This is referred to in more detail in the 2013 Annual Report and Accounts. The carrying value of these assets on the balance sheet at 30 June 2014 is £114.4m (31 December 2013: £127.8m).

## IT and other services

Pending the outcome of discussions regarding the sourcing of IT services, the Bank is not progressing the proposed revised IT Service Agreement (ITSA) and Professional Services Master Service Agreement (PSMSA) which were described in the 2013 Annual Report and Accounts. A number of service contracts under the PSMSA have now been terminated and services repatriated to the Bank, with the plan that all except pensions will be terminated by the end of 2014.

## 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 2014 and 31 December 2013 and their location within the Bank's balance sheet.

	30 June 2014			
	Loans and advances to customers	Other assets	Customer accounts	Other liabilities
The Co-operative Group	152.9	126.5	(130.4)	-
The Co-operative Banking Group Ltd	-	159.3	(30.4)	-
Subsidiaries of the Co-operative Banking Group Ltd	-	0.5	(77.7)	(71.4)
	152.9	286.3	(238.5)	(71.4)

31 December 2013

	Loans and advances to customers	Other assets	Customer accounts	Other liabilities
The Co-operative Group	110.1	126.6	(26.7)	-
The Co-operative Banking Group Ltd	-	303.2	(49.6)	-
Subsidiaries of the Co-operative Banking Group Ltd	-	-	(16.0)	(156.5)
	110.1	429.8	(92.3)	(156.5)

## 18. Share capital

	No. of shares (millions) Period to 30 June 2014	Share capital	No. of shares (millions) Period to 31 December 2013	Share capital
<b>Allotted, called up and fully paid (ordinary shares of 5p each)</b>				
At the beginning of the period	250	12.5	8,200	410.0
Shares cancelled	-	-	(8,200)	(410.0)
Issue of new ordinary shares	200	10.0	250	12.5
Issue of new bonus shares	1	0.1	-	-
At the end of the period	451	22.6	250	12.5

### Share premium account

At the beginning of the period	1,359.8	8.8
Issue of new ordinary shares	377.2	1,351.0
Issue of new bonus shares	(0.1)	-
At the end of the period	1,736.9	1,359.8

In March 2014, the Bank announced a £400.0m capital raising which was completed in May 2014. This resulted in an issuance of new ordinary share capital of £10.0m and a gross increase in share premium of £390.0m. Bonus shares of £0.1m were also issued. As part of the capital raising the Bank incurred transaction costs of £12.8m. These were offset against the gross share premium amount, giving a net increase in capital of £387.2m, of which £377.1m was recorded as share premium.

The number of ordinary shares in issue at 30 June 2014 was 451,456,510 (31 December 2013: 250,000,000).

The ordinary shareholders have one vote for every share held.

## 19. 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
<b>30 June 2014</b>							
<b>Assets</b>							
Cash and balances at central banks	-	-	6,103.7	-	-	-	6,103.7
Loans and advances to banks	-	-	1,644.6	-	-	-	1,644.6
Loans and advances to customers	-	167.6	27,668.8	-	-	-	27,836.4
Fair value adjustments for hedged risk	-	-	58.0	-	-	-	58.0
Investment securities	-	1,256.7	16.0	2,925.2	-	-	4,197.9
Derivative financial instruments	365.4	-	-	-	-	75.1	440.5
Equity shares	-	-	-	5.8	-	-	5.8
Other assets	-	-	400.3	-	-	-	400.3
<b>Total financial assets</b>	<b>365.4</b>	<b>1,424.3</b>	<b>35,891.4</b>	<b>2,931.0</b>	<b>-</b>	<b>75.1</b>	<b>40,687.2</b>
Non-financial assets							389.4
<b>Total assets</b>							<b>41,076.6</b>
<b>Liabilities</b>							
Deposits by banks	-	-	-	-	2,136.3	-	2,136.3
Customer accounts	-	-	-	-	31,070.1	-	31,070.1

Customer accounts - capital bonds	-	388.9	-	-	-	-	388.9
Debt securities in issue	-	-	-	-	3,880.8	-	3,880.8
Derivative financial instruments	188.7	-	-	-	-	292.4	481.1
Other borrowed funds	-	-	-	-	196.3	-	196.3
Other liabilities	-	-	-	-	166.7	-	166.7
<b>Total financial liabilities</b>	<b>188.7</b>	<b>388.9</b>	-	-	<b>37,450.2</b>	<b>292.4</b>	<b>38,320.2</b>
Non-financial liabilities							641.2
<b>Total liabilities</b>							<b>38,961.4</b>
Capital and reserves							2,115.2
<b>Total liabilities and equity</b>							<b>41,076.6</b>

IAS 39 requires derivative financial instruments that are not in a hedging relationship to be classified as 'held for trading'; this definition differs from the definition of 'derivatives held for trading purposes' as shown in the Bank's 2013 Annual Report and Accounts.

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
<b>31 December 2013 (restated)</b>							
<b>Assets</b>							
Cash and balances at central banks	-	-	5,418.8	-	-	-	5,418.8
Loans and advances to banks	-	-	1,594.4	-	-	-	1,594.4
Loans and advances to customers	-	134.2	30,188.0	-	-	-	30,322.2
Fair value adjustments for hedged risk	-	-	106.3	-	-	-	106.3
Investment securities	-	1,743.4	23.6	2,732.4	-	-	4,499.4
Derivative financial instruments	465.4	-	-	-	-	90.4	555.8
Equity shares	-	-	-	5.8	-	-	5.8
Other assets	-	-	480.9	-	-	-	480.9
<b>Total financial assets</b>	<b>465.4</b>	<b>1,877.6</b>	<b>37,812.0</b>	<b>2,738.2</b>	-	<b>90.4</b>	<b>42,983.6</b>
Non-financial assets							413.7
<b>Total assets</b>							<b>43,397.3</b>
<b>Liabilities</b>							
Deposits by banks	-	-	-	-	2,757.5	-	2,757.5
Customer accounts	-	-	-	-	32,463.3	-	32,463.3
Customer accounts - capital bonds	-	538.1	-	-	-	-	538.1
Debt securities in issue	-	-	-	-	4,207.6	-	4,207.6
Derivative financial instruments	191.7	-	-	-	-	346.9	538.6
Other borrowed funds	-	-	-	-	196.3	-	196.3
Other liabilities	-	-	-	-	202.9	-	202.9
<b>Total financial liabilities</b>	<b>191.7</b>	<b>538.1</b>	-	-	<b>39,827.6</b>	<b>346.9</b>	<b>40,904.3</b>
Non-financial liabilities							700.5
<b>Total liabilities</b>							<b>41,604.8</b>
Capital and reserves							1,792.5
<b>Total liabilities and equity</b>							<b>43,397.3</b>

The 2013 comparatives have been restated as described in note 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 and trading income. Held for trading investments are traded solely for short term profit.

##### Deposits by banks and debt securities in issue

The Bank issues medium term notes within an established Euro medium term note programme and also issues certificates of deposit and commercial paper as part of its normal treasury activities. These sources of funds, alongside other borrowed funds, are invested in marketable investment grade debt securities and short term wholesale market placements and are used to fund customer loans.

#### Other borrowed funds

The Bank issues unsecured and secured notes from time to time as part of its treasury activity. These sources of funds may be invested, held in cash, or used to fund customer deposits.

#### 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.

#### Foreign exchange

The Bank undertakes foreign exchange dealing to facilitate customer requirements and to generate incremental income from short term trading in the major currencies.

### 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

30 June 2014	Fair value at end of the reporting period using:			Total
	Level 1	Level 2	Level 3	
<b>Non-derivative financial assets</b>				
Designated at fair value:				
Loans and advances to customers	-	160.1	7.5	167.6
Investment securities	1,256.7	-	-	1,256.7
Available for sale financial assets:				
Investment securities	2,729.8	195.4	-	2,925.2
Equity shares	0.1	5.7	-	5.8
<b>Derivative financial instruments</b>	-	411.1	29.4	440.5
<b>Non-financial instruments</b>				
Investment properties	-	156.0	2.0	158.0
<b>Total assets carried at fair value</b>	<b>3,986.6</b>	<b>928.3</b>	<b>38.9</b>	<b>4,953.8</b>
<b>Non-derivative financial liabilities</b>				
Designated at fair value:				
Customer accounts - capital bonds	-	388.9	-	388.9
<b>Derivative financial instruments</b>	-	432.5	48.6	481.1
<b>Total liabilities carried at fair value</b>	-	821.4	48.6	870.0

31 December 2013	Fair value at end of the reporting period using:			Total
	Level 1	Level 2	Level 3	
<b>Non-derivative financial assets</b>				
Designated at fair value:				
Loans and advances to customers	-	125.5	8.7	134.2
Investment securities	1,743.4	-	-	1,743.4
Available for sale financial assets:				
Investment securities	2,497.2	235.2	-	2,732.4
Equity shares	0.1	5.7	-	5.8



<b>Derivative financial instruments</b>	-	525.3	30.5	555.8
<b>Non-financial instruments</b>				
Investment properties	-	157.9	6.2	164.1
<b>Total assets carried at fair value</b>	<b>4,240.7</b>	<b>1,049.6</b>	<b>45.4</b>	<b>5,335.7</b>
<b>Non-derivative financial liabilities</b>				
Designated at fair value:				
Customer accounts - capital bonds	-	538.1	-	538.1
<b>Derivative financial instruments</b>	-	477.4	61.2	538.6
<b>Total liabilities carried at fair value</b>	-	<b>1,015.5</b>	<b>61.2</b>	<b>1,076.7</b>

The carrying values of financial assets and liabilities 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 include corporate loans of £160.1m (31 December 2013: £125.5m) which are fair valued through income or expense 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 (ie 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.

##### Investment properties

Investment properties are carried at fair value. For those within level 2, fair value is calculated by using a mid-point of a range of valuations for the entire portfolio, index linked to the balance sheet date using the relevant regional house price index where appropriate.

##### 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 primarily relate to investments held in Vocalink Limited which are unquoted shares. The valuation of these shares is based on the Bank's percentage shareholding and the net asset value of the company according to its most recently published financial statements.

#### 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 £7.5m (31 December 2013: £8.7m) which are fair valued through income or expense 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 £nil in 2014 (31 December 2013: £0.8m increase). A reasonable change in the assumptions would not result in any material change in the valuation.

#### Derivative financial instruments

Derivative financial instruments in the form of interest rate swaps have been entered into between the Bank and its subsidiaries, and external counterparties.

The purpose of the swaps is to convert the SVR and base rate linked revenue receipts of the pool of mortgage assets to the same LIBOR linked basis as the intercompany loan. Under this swap arrangement the Bank's subsidiaries pay to the swap counterparty, the monthly SVR and base rate linked revenue receipts of the pool of assets and receives from the swap counterparty LIBOR plus a contractual spread on the same notional balance. The Bank has a 'back to back' swap that is the mirror image of the subsidiaries' swaps.

The swaps are valued based on an assumed amortisation profile of the pool of assets to the bond maturity date (assuming some annual prepayment), an assumed profile of customer receipts over this period, and LIBOR prediction using forward rates. Swap cash flows are discounted to present value using mid-yield curve zero coupon rates.

#### Investment properties

Investment properties within level 3 are valued by taking the original price, index linked to 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 year	Purchases and transfers in	Sales and transfers out	Income or expense including impairment	Fair value at the end of the period
<b>30 June 2014</b>					
Loans and advances to customers	8.7	-	(1.0)	(0.2)	7.5
Derivative assets	30.5	0.7	(0.1)	(1.7)	29.4
Derivative liabilities	(61.2)	(0.7)	0.1	13.2	(48.6)
Investment properties	6.2	-	(4.3)	0.1	2.0
	<b>(15.8)</b>	<b>-</b>	<b>(5.3)</b>	<b>11.4</b>	<b>(9.7)</b>
<b>31 December 2013</b>					
Loans and advances to customers	11.2	-	(1.7)	(0.8)	8.7
Derivative assets	35.4	12.6	(22.6)	5.1	30.5
Derivative liabilities	(12.4)	(52.0)	0.6	2.6	(61.2)
Investment properties	173.0	-	(166.6)	(0.2)	6.2
	<b>207.2</b>	<b>(39.4)</b>	<b>(190.3)</b>	<b>6.7</b>	<b>(15.8)</b>

During the prior period, the methodology for calculating the fair value of investment properties was amended as explained in the Bank's 2013 Annual Report and Accounts. During the current period, investment properties totalling £4.3m were transferred from level 3 to level 2. The transfer was made following identification of third party pricing information. The majority of investment property meets the level 2 fair value hierarchy.

#### 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.

	Carrying value	Fair value	Difference
<b>Financial assets</b>			
Loans and receivables			
Loans and advances to banks	1,644.6	1,643.7	(0.9)
Loans and advances to customers	27,668.8	25,836.0	(1,832.8)
Fair value adjustments for hedged risk	58.0	58.0	-
Investment securities	16.0	15.6	(0.4)
Other assets	400.3	400.3	-
<b>Financial liabilities</b>			
Financial liabilities at amortised cost			
Deposits by banks	2,136.3	2,136.2	(0.1)
Customer accounts	31,070.1	31,065.7	(4.4)
Debt securities in issue	3,880.8	4,319.0	438.2
Other borrowed funds	196.3	243.3	47.0
Other liabilities	166.7	166.7	-

31 December 2013 (as restated)			
	Carrying value	Fair value	Difference
<b>Financial assets</b>			
Loans and receivables			
Loans and advances to banks	1,594.4	1,594.4	-
Loans and advances to customers	30,188.0	27,813.0	(2,375.0)
Fair value adjustments for hedged risk	106.3	106.3	-
Investment securities	23.6	21.4	(2.2)
Other assets	480.9	480.9	-
<b>Financial liabilities</b>			
Financial liabilities at amortised cost			
Deposits by banks	2,757.5	2,757.4	(0.1)
Customer accounts	32,463.3	32,488.3	25.0
Debt securities in issue	4,207.6	4,714.9	507.3
Other borrowed funds	196.3	234.2	37.9
Other liabilities	202.9	202.9	-

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 is calculated by segmenting the overall balance into Retail, Optimum and Corporate.

#### (i) Retail and Optimum

Fair values have been calculated using an origination spread income approach. Under this approach, value is measured by determining discounted expected cashflows, derived using redemption profiles, from the portfolio and applying an origination spread which reflects the difference between current market rates for products with similar characteristics and risk profiles and the actual rates the portfolio is generating. The discount rates applied to the expected cashflows reflect the underlying risk of the portfolios.

#### (ii) Corporate

As part of the implementation of the Bank's strategy for Non-core assets, certain assets have either already been sold after the period end or plans to sell are well advanced. For these assets, the fair value can therefore be determined from the actual sale price achieved or expected to be received.

For other corporate assets an expected cashflow income approach has been used. Under this approach, value is measured by determining expected cashflows, derived using redemption profiles from the portfolio and then considering credit costs, funding costs and tax to derive cash flows which are discounted at an appropriate blended cost of capital. The discount rates applied to the expected cash flows reflect the underlying risk of the portfolios.

The fair value of loans and advances to customers is 93% of the carrying value as at 30 June 2014 (31 December 2013: 92%). The overall fair values are less than par primarily due to two main factors for Non-core loans in particular:

1. Customer interest rates are below the market rate at the balance sheet date until expected maturity or the repricing date, if earlier; and
2. Credit risk adjustments due to incurred and expected future credit losses.

#### 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 are calculated based on quoted market prices. For those notes where 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 effective lives of the assets and liabilities. As at 30 June 2014, the remaining merger fair value unwinds and the forecast unwind profiles can be summarised as follows:

	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 2014	Forecast Unwind			
				2014	2015	2016	2017 +
<b>Assets</b>							
Loans and advances to customers	27,836.4	(34.2)	(8.5)	(2.1)	(3.1)	(2.9)	(22.7)
Fair value adjustment for hedged risk	58.0	(30.3)	(7.3)	(3.0)	(4.4)	(3.6)	(19.3)
Other	13,182.2	20.4	2.6	2.3	4.6	4.6	17.6
<b>Total assets</b>	<b>41,076.6</b>	<b>(44.1)</b>	<b>(13.2)</b>	<b>(2.8)</b>	<b>(2.9)</b>	<b>(1.9)</b>	<b>(24.4)</b>
<b>Liabilities</b>							
Debt securities in issue	3,880.8	447.3	53.8	60.0	148.7	179.6	58.9
Deferred tax liabilities	77.8	(82.6)	-	-	-	-	-

Other	35,002.8	(9.0)	0.4	-	-	-	-
<b>Total liabilities</b>	<b>38,961.4</b>	<b>355.7</b>	<b>54.2</b>	<b>60.0</b>	<b>148.7</b>	<b>179.6</b>	<b>58.9</b>

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

Issue Name	Issue Date	Contractual 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 2014	Forecast Unwind			
							2014	2015	2016	2017
Leek Finance Number Seventeen plc	April 2006	June 2016	597.2	599.1	98.8	17.3	19.8	48.7	30.3	-
Leek Finance Number Eighteen plc	October 2006	December 2016	729.0	724.5	147.8	19.0	21.4	52.6	73.8	-
Leek Finance Number Nineteen plc	April 2007	June 2017	717.4	715.4	210.7	16.8	19.6	50.9	79.9	60.3
<b>Total Leek Notes</b>			<b>2,043.6</b>	<b>2,039.0</b>	<b>457.3</b>	<b>53.1</b>	<b>60.8</b>	<b>152.2</b>	<b>184.0</b>	<b>60.3</b>

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

Issue Name	Issue Date	Contractual 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 2014	Forecast Unwind			
							2014	2015	2016	2017
Internally Held Leek Notes			557.8	539.9	10.7	2.1	2.1	4.1	3.6	0.9

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.

30 June 2014				
	Carrying value	Level 1	Level 2	Level 3
<b>Financial assets</b>				
Loans and receivables				
Loans and advances to customers	27,668.8	-	-	25,836.0
Fair value adjustment for hedged risk	58.0	-	-	58.0
Investment securities	16.0	15.6	-	-
<b>Financial liabilities</b>				
Financial Liabilities at amortised cost				
Customer accounts	31,070.1	-	31,065.7	-
Debt securities in issue	3,880.8	844.4	3,474.6	-
Other borrowed funds	196.3	-	243.3	-

31 December 2013 (as restated)

	Carrying value	Level 1	Level 2	Level 3
<b>Financial assets</b>				
Loans and receivables				
Loans and advances to customers	30,188.0	-	-	27,813.0
Fair value adjustment for hedged risk	106.3	-	-	106.3
Investment securities	23.6	21.4	-	-
<b>Financial liabilities</b>				
Financial liabilities at amortised cost				
Customer accounts	32,463.3	-	32,488.3	-
Debt securities in issue	4,207.6	892.5	3,810.1	-
Other borrowed funds	196.3	-	234.2	-

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

#### 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 mortgagers in respect of the underlying mortgages.

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 the underlying mortgages.

The results of the securitisation vehicles are consolidated into the results of the Bank. 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 subsidiaries companies, some of these issued notes are held internally by the Company 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 position
<b>30 June 2014</b>					
Leek Finance Number Seventeen plc	570.9	597.2	502.2	599.1	(96.9)
Leek Finance Number Eighteen plc	684.7	729.0	603.8	724.5	(120.7)
Leek Finance Number Nineteen plc	662.0	717.4	583.8	715.4	(131.6)
Leek Finance Number Twenty plc	1,394.8	1,369.8	1,171.0	1,338.4	(167.4)
Leek Finance Number Twenty One plc	806.3	818.4	735.1	764.5	(29.4)
Leek Finance Number Twenty Two plc	364.4	380.3	300.7	358.1	(57.4)
Silk Road Finance Number One plc	1,304.8	1,314.6	1,226.6	1,315.3	(88.7)
Silk Road Finance Number Two plc	473.8	482.3	470.0	457.1	12.9
Silk Road Finance Number Three plc	514.5	526.9	499.0	533.8	(34.8)
Cambric Finance Number One plc	1,056.2	1,097.7	1,145.4	1,070.0	75.4
Meerbrook Finance Number Eight Ltd	636.3	640.6	604.2	608.0	(3.8)
	8,468.7	8,674.2	7,841.8	8,484.2	(642.4)

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** **8,674.2**

Internally held fixed and floating rate notes	(5,296.9)
Loan facilities and subdebt not included in debt securities in issue	(606.4)
Non securitised debt securities	1,586.4
Merger fair value adjustment	(447.3)
Other adjustments	(29.2)

**Debt securities in issue per financial liabilities** **3,880.8**

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 position
<b>30 June 2014</b>					
Leek Finance Number Seventeen plc	151.7	158.7	133.5	154.4	(20.9)
Leek Finance Number Eighteen plc	186.7	198.8	164.7	189.1	(24.4)
Leek Finance Number Nineteen plc	184.8	200.3	163.0	196.4	(33.4)
Leek Finance Number Twenty plc	1,394.8	1,369.8	1,171.0	1,338.4	(167.4)
Leek Finance Number Twenty One plc	806.3	818.4	735.1	764.5	(29.4)
Leek Finance Number Twenty Two plc	364.4	380.3	300.7	358.1	(57.4)
Silk Road Finance Number One plc	809.3	815.4	760.8	812.8	(52.0)
Silk Road Finance Number Two plc	154.6	149.6	153.3	147.2	6.1
Silk Road Finance Number Three plc	105.5	108.0	102.3	107.7	(5.4)
Cambric Finance Number One plc	1,056.2	1,097.7	1,145.4	1,070.0	75.4
Meerbrook Finance Number Eight Ltd	-	-	-	-	-
	<b>5,214.3</b>	<b>5,297.0</b>	<b>4,829.8</b>	<b>5,138.6</b>	<b>(308.8)</b>

The above carrying value and fair value of assets held for each entity have 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 difference between the fair value and carrying value of the mortgage assets that have been securitised within Leek 17, 18 and 19 is significantly higher than the fair value to carrying value difference for the associated liabilities. This is because it is expected that the note liabilities will be repaid before most of the underlying mortgages - which will continue to be held on the Bank's balance sheet for a significant period after the notes have repaid. These mortgages typically have an interest rate which is below the equivalent market rate at the balance sheet date for loans of 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.

	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 position
<b>31 December 2013</b>					
Leek Finance Number Seventeen plc	588.8	624.6	490.9	619.4	(128.5)
Leek Finance Number Eighteen plc	703.1	762.5	592.3	748.1	(155.8)
Leek Finance Number Nineteen plc	680.5	749.6	573.0	737.1	(164.1)
Leek Finance Number Twenty plc	1,438.2	1,413.3	1,135.1	1,364.0	(228.9)
Leek Finance Number Twenty One plc	850.1	864.1	770.1	784.6	(14.5)
Leek Finance Number Twenty Two plc	372.6	389.0	309.1	356.0	(46.9)

Silk Road Finance Number One plc	1,466.4	1,481.2	1,466.4	1,486.3	(19.9)
Silk Road Finance Number Two plc	562.0	561.1	562.5	563.4	(0.9)
Silk Road Finance Number Three plc	583.1	597.9	584.2	604.6	(20.4)
Cambric Finance Number One plc	1,339.8	1,384.5	1,238.8	1,310.9	(72.1)
Meerbrook Finance Number Eight Ltd	625.9	635.8	616.1	601.4	14.7
	9,210.5	9,463.6	8,338.5	9,175.8	(837.3)

#### Covered Bond Limited Liability Partnerships

Moorland Covered Bonds LLP was originally established to enable a £1.4bn retained covered bond 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. Following the attainment of 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 2013: £0.6bn) and a capital contribution of £0.7bn (31 December 2013: £0.9bn) 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 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 position
<b>30 June 2014</b>					
Moorland Covered Bonds LLP	1,274.0	596.3	1,264.2	642.7	621.5

	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 position
<b>31 December 2013</b>					
Moorland Covered Bonds LLP	1,448.8	596.1	1,417.9	628.4	789.5

#### 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 position
<b>30 June 2014</b>					
Investment securities sold under repurchase agreements	896.1	904.1	899.1	904.1	(5.0)

	Carrying amount of assets not derecognised	Carrying amount of associated liabilities	Fair value of assets not derecognised	Fair value of associated liabilities	Net position
<b>31 December 2013</b>					
Investment securities sold under repurchase agreements	1,004.4	1,028.3	1,022.5	1,028.3	(5.8)



Associated liabilities are included within deposits by banks.

## 20. Post balance sheet events

It is a requirement of IAS 10 (Events after the balance sheet date) that these financial statements reflect events arising after the 30 June 2014. The following events have occurred between 30 June 2014 and 21 August 2014 (the date of approval of the Interim Financial Report 2014) and represent 'non adjusting' post balance sheet events:

On 25 July 2014 the Bank gave notice that Silk Road Finance Two Plc will redeem all outstanding notes at their then principal amount outstanding together with accrued interest on 22 September 2014. As at 23 June 2014, £0.3bn of "Silk 2" class A notes were outstanding.

On 25 July 2014 the Bank announced the planned closure of a further 25 branches by the end of 2014. This would result in a further provision of £5.2m.

The Bank's 2014 Interim results are available to download from [www.co-operative.co.uk/investorrelations](http://www.co-operative.co.uk/investorrelations)

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This announcement and any related materials may contain or incorporate by reference certain "forward-looking statements" regarding the belief or current expectations of the Bank or the Bank Board (as applicable) about the Bank's financial condition, results of operations and business described in this announcement. Generally, but not always, words such as "target", "will", "expect", "estimate", "anticipate" or their negative variations or similar expressions identify forward-looking statements. Examples of forward-looking statements include, among others, statements regarding the Bank's future financial position, income growth, assets impairment charges and provisions, business strategy, capital, leverage and other regulatory ratios, payment or dividends, projected levels of growth in the banking and financial markets, projected costs, original and revised commitments and targets in connection with the turn-around plan, deleveraging actions, estimates of capital expenditures and plans and objectives for future operations and other statements that are not historical fact. Such forward-looking statements are not guarantees of future performance. Rather, they are based on current views and assumptions and involve known and unknown risks, uncertainties and other factors that may cause the actual results, performance, achievements or developments of the Bank or the industry in which it operates to differ materially from any future results, performance, achievements or developments expressed or implied from the forward-looking statements. The ability of the Bank to implement its strategic plan and to achieve the results set out in the plan entails particular challenges including (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 its asset reduction exercise; meeting its planned improvements in net interest margin; a possible further deterioration in the quality of the Bank's asset portfolio; unplanned costs from (for example) conduct risk matters; ability to maintain the Bank's access at an appropriate cost to liquidity and funding and the ability of the Bank to raise further capital assumed in its forecasts. Many of the risks and uncertainties also relate to factors that are beyond the Bank's ability to control or estimate precisely which include (without limitation) factors such as: UK domestic and global economic and business conditions; the Bank's ability to implement successfully its four to five year business plan to improve its financial, operational performance and capital position; market related risks, including but not limited to, changes in interest rates and exchange rates; changes to law, regulation, accounting standards or taxation, including changes to regulatory capital or liquidity requirements and the Bank's ability to meet those requirements; the ability to access sufficient funding to meet the Bank's liquidity needs including through retail deposits; instability in the global financial markets, including Eurozone instability and the impact of any sovereign credit rating downgrade or sovereign financial issues; changes to the Bank's credit rating; the effect of competition and the actions of competitors; the impact of potential disruption to the Bank's IT and communications systems; the ability to attract and retain skilled personnel; uncertainties regarding the extent of the Bank's exposure to pensions related liabilities; exposure to increased and ongoing regulatory scrutiny, legal proceedings, regulatory investigations or complaints, including with respect to conduct issues and other factors.

A number of material factors could cause actual results to differ materially from those contemplated by the forward-looking statements. The forward-looking statements contained in this announcement speak only as of the date of this announcement. Except as required by law, the Bank undertakes no obligation to revise the forward-looking statements to reflect any change in the Bank's expectations with regard thereto or any subsequent events or circumstances. Recipients of this announcement should not place any reliance on the forward-looking statements and are advised to make their own independent analysis and determination with respect to the forecast periods.

Basel III has been implemented in the EU through the new Capital Requirements Regulation and a further iteration of the Capital Requirements Directive. Together the new rules are known as CRD IV and came into effect 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 announcement are based on the Bank's interpretation of published rules. There is a risk that the final content of the technical standards may differ materially from current expectations and that the Bank may become subject to regulatory capital requirements not currently anticipated or provided for.

In the December 2013 PS7/13 Policy Statement PRA announced that, with the exception of available-for-sale unrealised gains, CRD IV deductions and filters would be implemented in full from 1 January and there would be no transition to full implementation. All CRD IV disclosures in this announcement are shown on a fully loaded basis.

Furthermore, you should consult with your own legal, regulatory, tax, business, investment, financial and accounting advisors to the extent that you deem it necessary, and make your own investments, hedging and trading decisions based upon your own judgement and advice from such advisers as you deem necessary and not upon any view expressed in this material.

Certain data in this announcement has been rounded. As a result of such rounding, the totals of data presented in this announcement may vary slightly from the arithmetic totals of such data.

Neither the Bank nor any of its respective affiliates or representatives undertakes any obligation to update or revise forward looking statements, whether as a result of new information, future events or otherwise, except to the extent legally required. Recipients of this announcement should not place any reliance on the forward looking statements and are advised to make their own independent analysis and determination with respect to the forecast periods.