The Co-operative Bank Holdings Ltd
and The Co-operative Bank plc

Annual Report and Accounts 2018

The **co-operative** bank

Preface

The consolidated financial statements for the year ended 31 December 2018 comprise:

The "Group"	The Co-operative Bank Holdings Limited and its controlled entities
The "Bank"	The Co-operative Bank plc and its controlled entities

Entity only results for the year ended 31 December 2018 comprise:

"Holding Company"	The Co-operative Bank Holdings Limited
"Bank Company"	The Co-operative Bank plc

The Holding Company has no trading operations of its own. In 2017 it acquired a 100% shareholding in the Bank. The consolidated financial statements, governance and risk management for the Group are substantially the same as those for the Bank. The 2018 Annual Report and Accounts have been prepared on a basis that covers both Group and Bank reporting requirements, but highlighting explicitly where Group and Bank differ.

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KEY PERFORMANCE INDICATORS

The Key Performance Indicators (KPIs) presented below reflect the way in which the performance of the Group was measured in 2018. For definitions of KPIs including how they are calculated and why these indicators are important to the business, refer to the glossary on page 218.

			2018	**2017**
Financial performance	Group (loss)/profit before tax [1]	£million	**(140.7)**	216.0
	Operating profit/(loss) [2]	£million	**14.9**	(84.0)
	Customer net interest margin	Percentage	**2.05**	1.73
	Operating cost:income ratio	Percentage	**97.1**	115.7
	Bank loss before tax	£million	**(140.7)**	(174.4)
Capital and liquidity	Common equity tier 1 (CET1) [3,4]	Percentage	**22.3**	24.7
	Total risk weighted assets (RWA)	£billion	**5.1**	5.1
	Liquidity coverage ratio [5]	Percentage	**153.8**	213.0
Trading KPIs	Customer assets	£billion	**17.7**	16.7
	Mortgage completions	£billion	**4.3**	3.4
	Mortgage net lending	£billion	**1.4**	0.1
	Customer deposits	£billion	**18.7**	20.6
Non-financial KPIs	Total current account holders	Million	**1.3**	1.4
	Prime current account holders	Thousands	**627**	648
	Net promoter score	Points	**19**	20
	Colleague engagement	Percentage	**80**	75

The definition, and where appropriate the calculation, of KPIs is provided in the glossary on pages 218.

Note:

1 For 2017 the Group adjusted loss before tax was £140.3 million. This represents the underlying performance, excluding the income statement gain from the Restructuring and Recapitalisation.

2 The operating profit/(loss) stated above is a non-GAAP measure management uses to assess business performance. It is reconciled to the relevant GAAP measures on page 12. Further, the 2017 balance includes a re-categorisation, additional information on which is included on page 15.

3 The minimum Pillar 1 capital requirement for common equity tier 1 is 8.0%.

4 Also represents total capital ratio, given the Group did not hold additional capital as at either 31 December 2018 or 31 December 2017.

5 The minimum regulatory liquidity coverage ratio is 100%.

Our vision and future strategy is described within the Chief Executive’s review on page 9.

KEY HIGHLIGHTS AND OUTLOOK

Building a sustainable business

- Despite making an overall loss before tax, the Bank has reported an operating profit for the first time since 2013.

- Drawdown of £1bn Term Funding Scheme (TFS) liquidity in the first quarter of 2018, supporting positive new lending in the mortgage portfolio.

- The Bank has been selected to be part of the Incentivised Switching Scheme (funding to challenger banks in order to incentivise RBS's Williams and Glyn SME banking customers to switch their business current accounts).

- The sectionalisation of the Pace pension scheme has been completed during the year, marking a key step towards full separation from Co-operative Group, delivering on a key commitment from the 2017 Restructuring and Recapitalisation.

Values and Ethics at the heart of our business

- Our partnership with the young people's homelessness charity Centrepoint, continued during 2018 and, together with our colleagues and customers, we have now raised over £1m to tackle this key social issue, helping to fund a national helpline for Centrepoint, and a specialist helpline service based in Manchester.

- Our support for new and developing co-operatives continues with our investment of £1.3m over four years in The Hive, a business start-up consultancy service which has now helped over 642 co-operative businesses across the UK.

- We were pleased to see the successful outcome of our 2016 campaign with Refuge, which in 2018 resulted in the launch of a new banking industry code of practice for customers affected by financial abuse.

- Our colleague engagement scores reached 80% in 2018, the highest levels since 2013.

Trading performance

- Positive mortgage net lending of £1.4bn is driven through Platform, resulting in the highest year of mortgage completions since 2010. The increased level of completions reflects the careful redeployment of liquidity driven from the 2017 Optimum securitisation and 2018 TFS facility.

- Action has been taken to optimise customer deposits due to the Bank's high liquidity position driven by the reasons outlined above. This is predominantly in relation to term savings accounts where limited acquisition and managed retention levels have driven a £1.3bn decrease, reducing the Bank's cost of funds.

- Whilst the number of current account holders overall have reduced, this is mainly driven by a reduction in dormant accounts. Therefore our current accounts (in value terms) have remained stable reflecting the continued loyalty of our customers.

- The Incentivised Switching Scheme which commenced in February 2019 provides a unique opportunity for the Bank to attract SME customers and contribute to improving competition in the SME market. Over 200,000 RBS customers are eligible for the scheme and we have invested time and resource in our SME proposition and on-boarding processes to ensure that we are well placed to attract eligible RBS customers who are interested in switching their banking to an ethical SME bank.

- We have continued to improve our digital capability. In the last quarter of the year, our new banking app was delivered and there has been considerable uptake in the short period of time since the launch.

- In November, we became the first UK bank to successfully implement the banking industry's digital cheque imaging programme.

Financial performance

- An operating profit of £14.9m has been generated, driven by continued cost reduction and a stable income profile.

- The Group loss before tax slightly increases to £140.7m (2017: £140.3m). 2017 excludes the impact of the Restructuring and Recapitalisation income statement gain. The Bank loss before tax reduces by £33.7m to £140.7m (2017: £174.4m).

- Customer NIM improves to 2.05% (2017: 1.73%) driven by the reduced interest expense following the 2017 Restructuring and Recapitalisation.

- The £3.7m impairment gain for the year reflects one-off provision releases in relation to corporate customers, and gains from the sale of unsecured debt.

- Operating costs reduce by 13% to £374.0m, the result of continued focus to improve the operating cost:income ratio, which was 97.1% for 2018 (2017: 115.7%).

- Total investment spend of £112.9m increases by £39.8m compared to 2017 (2017: £73.1m) as a number of strategic initiatives progress, including IT separation from Co-operative Group, which has entered its final stage.

- The net customer redress charge of £31.7m is driven primarily by sustained levels of Payment Protection Insurance (PPI) activity, above the levels previously forecast. The current provision reflects the latest view of remaining PPI redress and associated costs until the 2019 time-bar.

- A reduction in the fair value of the Surrendered Loss Debtor (SLD) reflects a write-down of £28.1m. The fair value of the receivable is impacted by changes in a range of external factors as outlined within the financial statements, and in note 2.2.5 Fair value of the Surrendered Loss Debtor.

- We have recognised an expense in the year of £12.4m, in relation to the equalisation of Guaranteed Minimum Pensions (GMP).

- CET1 ratio reduces to 22.3% (2017: 24.7%) due to the loss incurred in the year. Risk Weighted Assets (RWAs) remain broadly stable as growth in lower-risk mortgage assets offsets the continued run down of the unsecured, Optimum and corporate portfolios.

Outlook for 2019

- We will aim to grow our customer assets, funded by an increase in customer liabilities.

- We will enhance and diversify our product offering to service the needs of our customers better. We will also progress brand awareness through increased marketing activity.

- To develop our strong business current account proposition, we will improve our on-boarding process, upgrade our online banking and expand our business savings account proposition.

- Activity to re-platform our mortgage and savings services will commence. This continues the Bank's brand reinvigoration journey, driving better value for our customers, and delivering improved product offerings and services.

- The IT separation from Co-operative Group is expected to be completed, enabling the Bank to be more dynamic in its system updates and improving the service levels to our customers.

- We plan to improve loss-absorbing capacity by issuing Minimum Requirements for own funds and Eligible Liabilities (MREL) qualifying debt of which, at least £200m will be Tier 2.

- NIM is expected to reduce in 2019 due to the planned issuance of this MREL qualifying debt and also the sustained pressure on mortgage margins.

- Whilst one of the main priorities continues to be the tight control of costs, we recognise that investment in our technology, and in our customer experience, is a priority in order to achieve our Plan. However, management has continued to identify ways to be more efficient operationally to offset the impact of this investment. The operating cost:income ratio is however, expected to increase as a function of the pressure on income.

- The CET1 ratio is expected to reduce, as a result of continued investment and income pressure.

Strategic Report

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The Strategic Report is written with reference to the Bank; however, information reported reflects the activities of the Bank and Group collectively.

CHAIRMAN'S STATEMENT

I am pleased to present my first Annual Report as Chairman of the Co-operative Bank. My appointment as Chairman in March 2018 coincided with the Bank beginning to see the end of a long period when the focus had inevitably been more on recapitalisation and related matters than on a long-term strategy. On behalf of the Board I would like to pass heartfelt thanks on to my predecessor, Dennis Holt and to Liam Coleman, who stepped down as CEO last July, for their immense contributions towards enabling the Bank to begin to look with more confidence towards its future. I would also like to extend my thanks to Aidan Birkett, Charles Bralver, Tom Wood and Laura Carstensen who stepped down from the Board during 2018, each having made a significant contribution in helping the Bank navigate the challenges of recent years and towards a new phase of development.

The Board we have in place has the right balance of experience and talent to supervise and guide the Executive. The newly approved strategic plan devised by Andrew Bester and colleagues since his appointment as CEO last July, gives the business real focus on what has to be achieved over the next few years.

During 2018, the financial performance of the Group was encouraging, driven by the continuing loyalty of its customers, resilient mortgage income in a tough market, and a strong focus on operating costs. This resulted in reporting an operating profit for the first time since 2013. Whilst recognising this achievement, the Board is of course aware that the business reported a loss overall, and that political and economic uncertainties will present challenges for us and all Banks.

Finally, the Board recognises that none of the past year's achievements would have been possible without the expertise and continuing efforts of a superbly dedicated group of colleagues who continue to act in the best tradition of The Co-operative Bank.

Robert Dench
Chairman
27 February 2019

CHIEF EXECUTIVE'S REVIEW

Since my appointment as CEO in July, I have spent time understanding the challenges and opportunities that The Co-operative Bank faces as we look to the future. It is clear that the Bank has overcome significant difficulties in recent years and that sizeable progress has been made in its turnaround. We are now well capitalised and have a safe foundation on which to build. Despite under-investment in our brand in recent years, we continue to be rated first for ethical perception among UK banks.[1]

As the Chairman has highlighted, we recorded an operating profit for the first time since 2013, but nevertheless, the business reported a loss overall. Our priority remains to return the Bank to a position of sustainable profitability in the future and, while generating an operating profit this year is an encouraging development, there is still work to do particularly in light of future expected margin pressure.

One of my first priorities has been to update our strategy and define a multi-year transformation plan that will ensure The Co-operative Bank remains competitive in the future. Central to this will be developing the Bank's trusted ethical brand further, placing the customer at the heart of our decision making processes, and enhancing our digital capabilities to continue to drive improvements across our propositions and services.

DELIVERING FOR OUR CUSTOMERS IN 2018

Our improved business performance in 2018 reflects the hard work and commitment of our colleagues who focus every day on delivering great service for our loyal customers. I would like to express my thanks to our customers for their loyalty and to our colleagues for their achievements, against a backdrop of political uncertainty and intense competition in the UK banking market.

The banking environment has been dominated by the two factors of continued low interest rates, resulting in an extremely competitive market, combined with the anticipated political uncertainty of Brexit. As a UK-focused bank, we anticipate that the direct impact of Brexit on our day-to-day operations will be limited. However, like other banks, it is prudent for us to monitor the potential impact on the wider UK economy and the resulting potential effect on our customers. There has been no appreciable change in our customers' behaviour, but we will continue to monitor the situation closely as 2019 unfolds.

During 2018, we delivered strongly in our key business areas. I would particularly like to highlight the resilient performance of our Platform mortgage business over the year. Despite a very competitive mortgage market, we achieved our highest volume of mortgage completions since 2010. This lending has been safe and of high quality.

Our success is the result of a focused pricing strategy and emphasis on adviser service. New products have been introduced that are designed to support first time buyers, including Help to Buy and higher loan-to-value lending products. We have also been able to retain increased numbers of existing mortgage customers. During 2018, we have continued to make a contribution to the youth homelessness charity, Centrepoint, with every mortgage product sold. Our new Home Cover insurance product has been rated five stars by Moneyfacts.

In current accounts, the value of balances overall has remained stable reflecting the continued loyalty of our 1.3 million current account customers. Our Everyday Rewards current account achieved Recommended Provider status from consumer organisation Which? and also received a Fairer Finance gold ribbon award.

Given our customers' strong desire to support ethical causes, they have chosen to donate their monthly rewards to our charity partners, raising a total of almost £289,000 in 2018 supporting our five charities; Refuge, Amnesty International, Oxfam, Hospice UK, Woodland Trust.

Savings balances reduced following planned changes in our pricing strategy over the year. We launched a new mobile application for current accounts in December and look forward to improving our digital proposition further during 2019 and the years ahead. In November, we were pleased to be the first UK bank to successfully implement the banking industry's digital cheque imaging programme.

Developing our SME banking business is a key priority for us as we build for the future. We are proud to support local communities by looking after the banking needs of circa 85,000 SMEs, including 750 co-operatives, 5,000 charities, and 218 credit unions. Our three primary business current accounts (Business Directplus, Community Directplus and FSB Business Banking) were rated Five Stars by Moneyfacts in 2018 and we were proud to be voted Moneyfacts Best Charity Bank for the third consecutive year.

We are delighted to have been selected for the Banking Competition Remedies' Incentivised Switching Scheme, and we believe our ethical brand, North West heritage and strong service culture will be attractive to many of the SME customers that are part of the scheme. This provides us with a unique opportunity to serve more SME customers and play our part in improving competition in the SME market. Whilst we were disappointed not to receive a grant following our application to pool A of the Capability and Innovation Fund, we intend to apply for funding as part of the pool B opportunity in March 2019.

De-risking and separation from Co-operative Group

Since 2013, the Bank has delivered a comprehensive programme of de-risking. This has resulted in a significant reduction in the size of the Optimum portfolio including a further de-leveraging transaction in 2017, further improving capital resilience subsequent to the Restructuring and Recapitalisation. In June 2018, we successfully concluded the sectionalisation of the Pace pension scheme, and delivered further cost reductions.

[1] Research produced by Hall and Partners

Colleague commitment and culture
Our colleagues are the driving force behind the success of the Bank and are integral to the great service we provide to our customers. We were delighted to be awarded Branch Network of the Year 2018 in the Moneyfacts Consumer Awards and our focus on service delivery remains one of our highest priorities.

In 2018, colleague engagement metrics reached 80%, the highest level since 2013. Our focus is to develop our culture further, which is defined by co-operative values and ethics and, as part of this, our drive to reinforce gender equality has resulted in a 4% increase of women in senior roles since we set our target in 2016. Our mean gender pay gap for 2018 was 29.9% and we believe the measures we are putting in place will result in a reduction in our pay gap over time.

Co-operative values, ethics and community
Our co-operative heritage and commitment to the values of the co-operative movement continue to be key for our customers and colleagues. We were pleased to see the successful outcome of our 2016 campaign with domestic abuse charity Refuge, which in 2018 resulted in the launch of a new banking industry code of practice for customers affected by financial abuse.

Our work with youth homelessness charity, Centrepoint, continued during 2018, and together with our colleagues and customers we have now raised over £1m to help tackle this growing issue. This has helped fund a national helpline for young people at risk of, or experiencing, homelessness which helped almost 5,000 young people during 2018 and has funded the launch of a new specialist support service based in Manchester.

Our support for new and developing co-operatives continues with our investment of £1.3m over four years in The Hive, a business start-up consultancy service which has now helped over 642 groups across the UK. Supporting the local community is a fundamental part of our commitment to co-operative values and in Manchester we have continued to play a key role in many community initiatives. Some particular highlights include being a sponsor of Manchester Pride for the third year running. We took part in the Bee in the City community art trail, helping to bring an economic benefit to the city of £33.5m.

A FUTURE STRATEGY FOR SUSTAINABLE COMPETITIVE ADVANTAGE
I am determined that our 2018 performance will provide a platform for the future success of the Bank. Together with my executive team, we have developed a strategy that will enable us to realise our vision of being a customer-centric, efficient and financially sustainable UK retail and SME bank distinguished by its values and ethics.

In driving our customer first approach, underpinned by our strong ethical foundation, we will invest in developing digital customer propositions, enhancing competitive products, and nurturing existing branch and telephony distribution channels to build sustainable competitive advantage. Our multi-year transformation plan will comprise three phases:

1. During 2019, the Bank will focus initially on continuing to energise and engage its loyal customer base through its ethical brand and customer-first approach to service. We will focus on developing our digital capabilities and conclude the separation of all IT systems from Co-operative Group whilst continuing to invest in aligning customer experience with the needs of our customers.

   As increasing number of consumers seek ethical choices in different aspects of their lives, the Bank will build on its leading ethical position and rich values-based heritage to promote ethical banking to our loyal customers and retail and SME customers more broadly.

   We are investing in renewed brand advertising with new campaigns beginning in February and running throughout 2019 and beyond. Our co-operative and ethical heritage will be a cornerstone of our plans and we will reinforce our position as the only UK retail bank to be headquartered in Manchester, playing our part in the local community.

   IT separation has been central to the de-risking of the Bank and the successful migration of the majority of our operational IT systems from those of Co-operative Group took place in 2017. In 2018, we continued to progress improvements in IT infrastructure. The final element of this IT separation is expected to conclude in 2019. The de-risking activity completed to date, and further planned separation activity provide the Bank with a solid foundation to enable future growth and deliver its strategy.

2. From 2020 onwards, the Bank will build on opportunities for growth across the product portfolio. This will result in an improved operating cost:income ratio, a continually strong capital position and resilient interest margins over the long term.

   We will achieve this by improving our retail banking proposition and growing our SME banking business. With increasing numbers of customers adopting digital services, internet and mobile banking applications will become the digital access point to the Bank's ethical proposition. Digitising the Bank successfully will ensure customers experience real-time, convenient banking which meets their expectations. At the same time, we will maintain our multi-channel approach, recognising the value our customers place on our award-winning telephony service. We are committed to our network of 68 branches and we want our branches to play a key part in supporting their local communities.

3. From 2022, a sustainable, long-term competitive advantage will emerge for the Bank from delivery of earlier stages of our strategy and plan. Co-operative values and ethics will continue to be central to our ongoing success.

Co-operative values and ethics define our business
The Bank's distinctive brand has its heritage in the value and ethics of the co-operative movement and is defined by its customer-led Ethical Policy. The Policy has been in place since 1992, and has been developed reflecting the views of 320,000 customers and colleagues. It represents a clear point of difference that sets the Bank apart from its competitors.

Our Ethical Policy continues to be a key reason customers join the Bank and why it continues to be rated first for ethical perception for in-market non-customers. As increasing numbers of consumers seek ethical choices, the Bank intends to promote its ethical banking brand as an attractive option to a broad audience of retail and SME customers.

Clear, fair and transparent products meeting customer needs
Our focus on retail and SME customers will comprise three areas:

Current accounts and savings
We will enhance our current account offer through the continued development of our digital services and products that meet the needs of our customers. We will seek to grow market share in savings with an increased focus on retaining existing customers and attracting new customers, using our ethical approach as a differentiator. We will enhance our propositions and improve service, in line with changing customer needs.

Mortgages
We will continue to offer mortgages through our Platform intermediary brand. Our strategy is to support customers' home ownership aspirations and needs throughout their lives including provision for first-time buyers. Offering excellent customer service and good value products to a broader range of customers will differentiate the Bank's mortgage proposition and drive commercial value.

SME Banking
We plan to invest in our SME business, building on our strong business current account proposition and focus on serving smaller SMEs who are attracted by, and aligned with, our ethical brand. We will invest in our online banking platform and digitise the current account opening experience.

Providing our customers with a choice of channels
We are committed to supporting customers through the channels of their choice. With increasing numbers adopting digital services, key customer journeys will be digitally enabled to ensure customers experience real time convenient banking which meets their needs. At the same time, our network of 68 branches will be revitalised as the community access point to the Bank's ethical banking proposition and focal point for the Bank's role in local communities. Our award-winning customer contact teams will continue to support customer needs for advice, support and complex problem solving.

Delivering a future of sustainable profitability
Our strategy and transformation plan was agreed by the Board in December 2018 and supported by our shareholders. We are now focused on implementing our strategy and through its successful delivery we will improve profitability.

The political and economic uncertainty in the UK seems likely to continue at least in the short term. The advent of Open Banking and increasing digitisation in a low-interest rate environment is likely to result in sustained competition in the banking market. Achieving sustainable success in this environment will be challenging, but I believe we have the right ingredients to do so, with dedicated colleagues, a distinctive brand, and the commitment of our Board and shareholders. There is still much work to be done to reach our goal of a sustainable profitable Co-operative Bank, and we are committed to achieving this.

Andrew Bester
Chief Executive Officer
27 February 2019

BUSINESS ACTIVITIES IN 2018

We have described our future strategy for sustainable competitive advantage within the Chief Executive's review, along with our revised business segments. In 2019, our progress will be managed and reported in line with those new business segments. During 2019, we will simplify our financial reporting and consider ways to present the information in a way which reflects how our business is now managed internally, and also take the opportunity to refresh and condense the narrative presented.

During 2018, our progress was managed and reported in line with the segments identified at the start of the year. The information within the detailed business review and also within note 3 to the consolidated financial statements sets out the key elements of the performance of the Group on that basis. The table below shows a summary of segments as reported internally in 2018 and the comparative period.

Segment		Managed assets	Managed liabilities	Credit RWAs	Operating income/ (expense)
Retail banking	**2018:**	**£16.0bn**	**£16.6bn**	**£2.3bn**	**£303.0m**
	2017:	£14.7bn	£18.3bn	£1.9bn	£293.2m
Trades as The Co-operative Bank, Britannia and Smile, together with the Group's intermediary mortgage brand – Platform. Includes retail secured and unsecured lending as well as personal current account and savings products.					
Corporate[1]	**2018:**	**£1.2bn**	**£2.1bn**	**£1.0bn**	**£64.4m**
	2017:	£1.4bn	£2.2bn	£1.3bn	£53.5m
This combines a focus on: A. Offering banking products and services to meet the needs of SME customers, predominantly focused on savings and current accounts. We support our SME customers across our channels and seek new customers who have: • turnover of less than £25m; • borrowing requirements of less than £5m; or • otherwise meet risk appetite. However we continue to seek customers in the Charity and Co-operative sectors. B. Managing a historical portfolio which includes: • Corporates – which typically have a turnover of over £25m or otherwise do not meet risk appetite; • Commercial Real Estate; • Project Finance; • Housing Associations; • Local Authorities; and • Large scale Renewable Energy and Asset Finance.					
Optimum	**2018:**	**£0.5bn**	**£nil**	**£0.3bn**	**£12.4m**
	2017:	£0.6bn	£nil	£0.3bn	£7.7m
A closed book of predominantly interest-only, intermediary and acquired mortgage book assets.					
Treasury	**2018:**	**£4.5bn**	**£2.3bn**	**£0.3bn**	**£2.1m**
	2017:	£7.3bn	£2.1bn	£0.5bn	(£9.7m)
Manages the liquidity, wholesale funding and capital market transactions.					
Other	**2018:**	**£0.9bn**	**£0.3bn**	**£0.6bn**	**£3.3m**
	2017:	£0.5bn	£0.3bn	£0.4bn	£1.3m
Balance sheet and income statement items not directly related or managed within any of the operating segments above.					

1. This represents a combination of Business and Commercial Banking (BaCB) and Legacy portfolios.

DETAILED FINANCIAL REVIEW

The Board monitors Group performance on a management accounts basis; therefore numbers shown in this financial review are presented on this basis. A reconciliation of the management accounts to the statutory income statement can be seen in note 3 to the consolidated financial statements.

Summary income statement

	2018	Re-presented 2017[4]	Change
	£m	£m	£m
Net interest income	**350.5**	317.6	32.9
Other operating income	**34.7**	28.4	6.3
Operating income	**385.2**	346.0	39.2
Credit impairment gains	**3.7**	1.1	2.6
Income net of impairment	**388.9**	347.1	41.8
Operating costs – staff	**(129.2)**	(152.4)	23.2
Operating costs – non-staff	**(226.2)**	(258.9)	32.7
Continuous improvement projects[1]	**(18.6)**	(19.8)	1.2
Operating profit/(loss)	**14.9**	(84.0)	98.9
Net customer redress charge	**(31.7)**	(27.4)	(4.3)
Strategic projects	**(94.3)**	(53.3)	(41.0)
Non-operating (expense)/income	**(29.6)**	431.0	(460.6)
Share of post-tax profits from joint ventures	**-**	0.4	(0.4)
Fair value amortisation[2]	**-**	(50.7)	50.7
Group (loss)/profit before taxation	**(140.7)**	216.0	(356.7)
Customer net interest margin	**2.05%**	1.73%	0.32%
Operating cost:income ratio[3]	**97.1%**	115.7%	(18.6%)
Group (loss)/profit before taxation	**(140.7)**	216.0	(356.7)
Impact of Restructuring and Recapitalisation	**-**	(356.3)	356.3
Group adjusted loss before taxation	**(140.7)**	(140.3)	(0.4)
Group (loss)/profit before taxation	**(140.7)**	216.0	(356.7)
Group consolidation adjustment	**-**	(390.4)	390.4
Bank loss before taxation	**(140.7)**	(174.4)	33.7

1. Continuous improvement projects include regulatory and mandatory projects.
2. The remaining Britannia merger fair value was written off in 2017. Refer to note 34 to the consolidated financial statements in the 2017 Annual Report and Accounts for further information.
3. Operating cost:income ratio is calculated as operating costs (staff and non-staff) and continuous improvement project expenditure divided by operating income excluding losses on asset sales of £nil in 2018 (2017: £26.5m).
4. 2017 has been re-presented to show an updated split of expenditure in line with the current management and reporting of the costs. See below.

The Group generated a loss before tax of £140.7m in 2018. This compares to the 2017 adjusted loss before tax of £140.3m (before the impact of Restructuring and Recapitalisation). The 2017 statutory profit before tax was £216.0m. The Bank loss before tax of £174.4m in 2017 differs from the Group due to the accounting treatment of the Tier 2 notes. The Bank reports this as a capital contribution which is recorded in equity, as described in note 32 to the consolidated financial statements.

The Group has reported an operating profit of £14.9m, a £98.9m improvement on 2017, and the first operating profit reported since 2013. Net interest income has increased by £32.9m, largely as a result of a full year's benefit of the 2017 Tier 2 debt restructure and MTN maturity in 2017, reducing the Bank's interest expense. The remaining improvement in the operating performance mainly relates to the continued focus on cost reduction activities reducing net operating expenses by £57.1m.

The Group reports certain expenses below operating profit within the management accounts. These expenses, described as 'below the line expenditure', relate to items which may be non-recurring or need to be separately identified to understand the Group's financial performance more clearly. Below the line expenditure has increased by £99.3m (excluding impact of 2017 Restructuring and Recapitalisation). This increase reflects increased investment in strategic projects (£41.0m), and an increase in other non-operating expenses of £104.3m as discussed further below. These increases have been partially offset by a reduction to £nil of the fair value amortisation charge on the Britannia merger (2017: £50.7m) and a £4.3m increase in the level of customer redress charge to £31.7m.

Increase in operating income
Net interest income has increased largely as a result of the prior year Tier 2 debt restructure. Customer net interest income included within this balance has increased by £2.8m, largely driven by:

- retail increase of £15.7m;
- corporate increase of £4.3m; and
- Optimum decrease of (£17.2m).

The increase in retail net interest income is comprised of a reduction in more expensive customer deposits compared to 2017, driven by deposit optimisation following liquidity generated from the Warwick Finance Three securitisation and Term Funding Scheme (TFS) drawdown. This is further supported by improvements driven by the two base rate rises across 2017 and 2018.

The increase has been marginally offset by compression on mortgage margins as a result of continued competitive intensity in the market, which drives lower new business and retention margins. This compression impacts both maturing higher-yielding mortgage assets and lower-yielding front book originations, and is partially offset by a growing mortgage book driven by the Platform brand. The Bank also has a smaller unsecured portfolio in 2018 as a result of natural attrition.

The increase in corporate is comprised of benefits from the two base rate rises on the deposit franchise. This has been partially offset by a reduction in the corporate asset balances as they continue to run off.

The decrease in Optimum reflects the full year impact of a reduction in Optimum asset balances as a result of the Warwick Finance Three securitisation towards the end of 2017.

The customer net interest margin has increased by 0.32% to 2.05% (2017: 1.73%). This was predominantly driven by the restructure of the Bank's Tier 2 debt, driving 0.15% improvement across 2018, and improving customer liability margins contributing a 0.34% benefit. These liability margin improvements resulted from a reduction in the Group's more expensive deposits. Customer asset margins have reduced by 0.18% due to continued mortgage margin compression and reduced unsecured and Optimum portfolios compared to 2017. This pressure, along with the planned issuance of new Tier 2 debt, is expected to impact NIM as we move into 2019.

An increase in other operating income relates to the non-recurring loss on sale in 2017 due to the Warwick Finance Three securitisation and gains in 2018 relating to an increase in the Visa share valuation year-on-year. This has been further impacted by a reduction in customer fee income in the current portfolio.

Increase in credit impairment gains
The credit impairment gain has been calculated on an IFRS 9 basis in 2018, whilst the 2017 gain is based on IAS 39 methodology. As explained in note 1 to the financial statements, the comparatives have not been restated for the change in accounting policy and the impact of transition has been taken through reserves.

Credit impairment gains of £3.7m in 2018 compares with £1.1m gains in 2017. The significant components relate to:
- retail impairment charge in 2018 of £7.2m, which is £1.9m lower than prior year reflecting a number of debt sales in 2018 and 2017. During 2018, provision levels in the secured portfolio increased to reflect the growth in the Platform portfolio; and
- corporate impairment release in 2018 of £9.3m, which is £4.7m favourable to 2017. The movement is primarily driven by an £8.4m release on a single corporate customer.

A more detailed analysis of credit impairment is provided in the Risk Management report and in note 14 to the consolidated financial statements.

Reduction in operating expenses
Overall operating expenditure has reduced by £57.1m to £374.0m (2017: £431.1m); representing significant progress against the Group's cost reduction targets through simplification and rationalisation of activity.

Operating staff costs have reduced by £23.2m to £129.2m (2017: £152.4m). This reduction is primarily driven by lower headcount following implementation of various initiatives in 2018, and the annualised benefit of initiatives that were completed in 2017. Permanent employees (full time equivalents or FTE excluding project staff) have decreased by 418 in the year to 2,759 (31 December 2017: 3,177) along with a reduction in the number of short to medium term specialist contractors and temporary staff when compared to the end of 2017 (from 104 to 25 FTE).

Non-staff operating costs reduced by £32.7m to £226.2m (2017: £258.9m). The Group has reduced premises costs as a result of branch estate rationalisation and consolidation of head office locations. The Group has also seen overall lower third party spend and a reduction in processing costs as a result of changes in customer behaviour.

Increase in below the line expenditure

£m	**2018**	2017	Change
Strategic projects	**(94.3)**	(53.3)	(41.0)
Net customer redress charge	**(31.7)**	(27.4)	(4.3)
Non-operating (expense)/income	**(29.6)**	74.7	(104.3)
Share of post-tax profits from joint ventures	**-**	0.4	(0.4)
Fair value amortisation	**-**	(50.7)	50.7
Below the line expense before Restructuring and Recapitalisation	**(155.6)**	(56.3)	(99.3)
Gain on Restructuring and Recapitalisation	**-**	356.3	(356.3)
Total below the line (expense)/income	**(155.6)**	300.0	(455.6)

Expenditure on strategic projects increased by £41.0m to £94.3m. The largest individual project related to the mobilisation of the final stage of the separation of IT infrastructure from Co-operative Group (£19.8m). Other significant projects include the transformation of IT infrastructure (associated with separation), digital cheque imaging and improvements to mobile and telephony, associated with digital transformation (collectively totalling £26.2m). Other costs associated with strategic projects comprise severance (£15.4m), which was partly driven by the reduction in staff in the year; payments charges (£11.9m); improvements to mortgage processes (£5.3m); changing third party provider of card authorisation services £(4.8m); branch transformation activity (£4.0m) and smaller projects which together, totalled £6.7m in the year.

The charge for the net customer redress increased by £4.3m to £31.7m (2017: £27.4m). A charge of £39.5m was recognised in the year (2017: £38.5m) in respect of the total expected cost of carrying out work and paying compensation related to the historical sale of PPI policies. The provision increase reflects continued high complaint volumes received through 2018 and anticipated in 2019, in the lead up to the FCA-imposed time-bar. New provisions of £4.4m were recognised in respect of new or emerging issues, of which the majority relates to the mischarging of interest on further advance products.

The non-operating (expense)/income adverse variance is impacted by a £22.8m one-off gain in 2017 relating to the sale of the shares in VocaLink and a £51.9m one-off gain in 2017 relating to a change in the Britannia Pension Scheme index to determine inflationary increases from RPI to CPI. In addition, 2018 is negatively impacted by the £28.1m write-down of the Surrendered Loss Debtor and the £12.4m estimated impact of the equalisation of Guaranteed Minimum Pensions. The adverse overall variance in non-operating (expense)/income is partially reduced by a £10.9m gain in 2018 relating to the IAS 19 discount unwind of the Bank's pension scheme surpluses.

As explained on page 12, the remaining Britannia merger fair value was written off in 2017.

Re-presentation of 2017 income statement

The 2017 income statement includes a re-categorisation of project-related expenses from strategic, operational and remediation projects to strategic and continuous improvement projects to align with the current management reporting. The following adjustments have been made:

- depreciation – total reported above operating profit and moved to non-staff operating costs; and
- project re-allocations – re-analyse expenditure into strategic and continuous improvement projects.

	Prior basis	Depreciation	Project re-allocations	Current basis
2017 income statement re-allocation	£m	£m	£m	£m
Net interest income	317.6	-	-	317.6
Loss on asset sales	(26.5)	-	-	(26.5)
Non-interest income	54.9	-	-	54.9
Operating income	**346.0**	**-**	**-**	**346.0**
Credit impairment gains	1.1	-	-	1.1
Income net of impairment	**347.1**	**-**	**-**	**347.1**
Operating costs – staff	(152.6)	-	0.2	(152.4)
Operating costs – non-staff	(236.5)	(31.0)	8.6	(258.9)
Operating projects	(13.6)	12.5	1.1	-
Continuous improvement projects	-	-	(19.8)	(19.8)
Operating result	**(55.6)**	**(18.5)**	**(9.9)**	**(84.0)**
Net customer redress charge	(27.4)	-	-	(27.4)
Remediation project expenditure	(50.9)	5.1	45.8	-
Strategic projects	(30.8)	13.4	(35.9)	(53.3)
Non-operating income	431.0	-	-	431.0
Share of post-tax profits from joint ventures	0.4	-	-	0.4
Fair value amortisation	(50.7)	-	-	(50.7)
Group profit before taxation	**216.0**	**-**	**-**	**216.0**

Summary balance sheet

	2018 £m	Re-presented 2017 £m	Change
Retail secured mortgages	**15,494.7**	14,104.5	1,390.2
Retail unsecured	**477.1**	583.9	(106.8)
Total retail	**15,971.8**	14,688.4	1,283.4
Corporate[1]	**1,163.3**	1,442.0	(278.7)
Optimum	**529.5**	593.6	(64.1)
Other customer assets, impairments and accounting adjustments	**69.3**	20.5	48.8
Total customer assets	**17,733.9**	16,744.5	989.4
Treasury	**4,501.9**	7,258.3	(2,756.4)
Other assets	**867.0**	487.3	400.6
Total assets	**23,102.8**	24,490.1	(1,387.3)
Retail current accounts	**4,199.0**	4,186.7	12.3
Retail variable deposits	**8,242.8**	8,712.7	(469.9)
Retail term deposits	**4,153.5**	5,430.4	(1,276.9)
Total retail	**16,595.3**	18,329.8	(1,734.5)
Corporate[1]	**2,118.6**	2,225.4	(106.8)
Other customer liabilities and accounting adjustments	**21.9**	79.8	(57.9)
Total customer liabilities	**18,735.8**	20,635.0	(1,899.2)
Treasury	**2,309.3**	2,088.1	221.2
Other[2]	**307.6**	261.4	46.2
Total liabilities	**21,352.7**	22,984.5	(1,631.8)
Total equity[2]	**1,750.1**	1,505.6	244.5
Total liabilities and equity	**23,102.8**	24,490.1	(1,387.3)

The management accounts basis shows the balance sheet on a gross customer basis with impairments and other accounting adjustments on a separate line. 2017 has been re-presented on this basis.

1. Corporate is the amalgamation of the BaCB and Legacy portfolios as reported in the 2017 Annual Report and Accounts.
2. There is a difference of £0.1m in 2017 between the Group and Bank other liabilities and equity results. This relates to cash held by the Bank Company on behalf of the Holding Company.

Key movements in the balance sheet

Total customer assets have grown by £1.0bn in 2018 as a result of the highest year of mortgage completions since 2010, with positive mortgage net lending of £1.4bn being driven through the Bank's Platform channel supported by a full year's retention capability introduced in 2017. The Bank has come through a period of balance sheet consolidation and is now focused on growing customer asset balances, whilst retaining a loyal customer base. The growth in lending has partly been funded by the increased liquidity generated from the Optimum securitisation and TFS drawdown.

Whilst there has been no active deleveraging activity within the corporate book in 2018, growth in customer assets has been partially offset by the continuing natural attrition of the unsecured and corporate portfolios. Unsecured lending has reduced by £0.1bn year-on-year, due to limited new business and natural attrition of the balances.

Treasury assets reduced by £2.8bn to £4.5bn (2017: £7.3bn) in the year which reflects the high 2017 cash balance driven by the Optimum securitisation in October 2017. This has been further impacted by a reduction in mortgage backed securities due to a sale of Warwick Finance Three notes in the year.

Total customer liabilities have reduced by £1.9bn to £18.7bn (2017: £20.6bn) as a result of active funding optimisation which took place throughout 2018, as the Group utilised the excess liquidity freed up from the Warwick Finance Three securitisation and TFS drawdown facility in 2017 and early 2018 respectively. The acquisition of savings balances has increased in the second half of the year to support the customer asset growth as the liquidity position normalises.

Term deposits have reduced by £1.3bn primarily due to the Bank allowing the run-off of the more expensive deposits generated during the recapitalisation in 2017.

Total equity has increased as a result of the recognition of the Pace pension surplus post sectionalisation of the scheme, partially offset by the loss in the year.

Capital and liquidity

Liquidity portfolio

£m unless stated	**As at 31 December 2018**	As at 31 December 2017	Change
Operational balances with central banks	**1,662.2**	3,815.5	(2,153.3)
Gilts	**532.1**	423.1	109.0
Central government and multi-lateral development bank bonds	**467.3**	348.7	118.6
Total primary liquid assets	**2,661.6**	4,587.3	(1,925.7)
Other liquid assets	**364.0**	1,186.1	(822.1)
Contingent liquidity	**3,999.4**	4,191.8	(192.4)
Secondary liquidity	**4,363.4**	5,377.9	(1,014.5)
Total liquidity	**7,025.0**	9,965.2	(2,940.2)
Average balance	**8,357.9**	9,151.5	(793.6)
Liquidity coverage ratio (%)	**153.8%**	213.0%	(59.2 ppt)
Loan to deposit ratio (%)	**94.7%**	81.1%	13.6 ppt
Encumbrance ratio (%)	**19.9%**	15.1%	4.8 ppt
Liquid asset ratio (%)	**11.5%**	18.7%	(7.2 ppt)

Absolute changes in percentages are described as changes in percentage points (ppt).

Liquidity resources, as at 31 December 2018, reduced from £10.0bn to £7.0bn, but continued to be in excess of minimum regulatory requirements.

Primary liquidity has reduced by £1.9bn to £2.7bn (2017: £4.6bn) and secondary liquidity has reduced by £1.0bn to £4.4bn (2017: £5.4bn). Primary liquidity consists of liquid assets that are eligible under European Banking Authority (EBA) regulations (High Quality Liquid Assets). The reduction in primary liquidity related mainly to the funding received from the Warwick Finance Three transaction in 2017 being deployed in 2018, returning the Bank's liquidity holdings to a more efficient level. Secondary liquidity comprises unencumbered investment securities not included as part of primary liquidity, as well as mortgage and corporate collateral eligible for central bank facilities. The reduction in secondary liquidity is a result of the Group's management of its holdings of Mortgage-Backed Securities (MBS).

Capital

Capital resources CRD IV

	31 December 2018 £m	31 December 2017 £m
CET1 before regulatory adjustments	**1,818.8**	1,505.6
Total regulatory adjustments to CET1	**(690.8)**	(249.9)
CET1	**1,128.0**	1,255.7
Additional Tier 1 (AT1) capital: instruments	**-**	-
Total Tier 1 capital (T1 = CET1 +AT1)	**1,128.0**	1,255.7
Total regulatory adjustments to T2 capital	**-**	-
T2 capital	**-**	-
Total capital (TC = T1 + T2)	**1,128.0**	1,255.7

Risk weighted assets		
Credit risk	**4,506.6**	4,449.6
Market risk	**-**	-
Operational risk	**546.9**	636.0
Total risk weighted assets	**5,053.5**	5,085.6

Capital ratios		
Common Equity Tier 1 ratio	**22.3%**	24.7%
Tier 1 ratio	**22.3%**	24.7%
Total capital ratio	**22.3%**	24.7%

Leverage ratio common disclosure		
Tier 1 capital	**1,128.0**	1,255.7
Total leverage ratio exposures	**24,020.7**	25,792.4
Leverage ratio	**4.7%**	4.9%

Other Capital Metrics		
Total Capital Requirement (TCR)	**843.4**	917.4
Surplus to regulatory minimum TCR	**284.6**	338.3
Overall Capital Requirement (OCR)	**988.7**	981.0
Surplus to regulatory minimum OCR	**139.3**	274.7

The Group's consolidated CET1, post regulatory deductions, has reduced from £1,255.7m to £1,128.0m at 31 December 2018. This is primarily driven by the £68.7m loss after tax.

CET1 resources before deductions increased by £313.2m to £1,818.8m (2017: £1,505.6m), which is driven by an increase in the defined benefit pension reserve following the recognition of the Pace pension surplus following sectionalisation of the scheme. The defined benefit pension asset is deducted from capital, and results in a net pension deduction to CET1 resources of £52.2m. A further increase in the CET1 deductions is the £32.9m increase in deferred tax assets deduction. This is driven by the recognition of Deferred Tax Assets (DTAs) relating to bringing Pace on balance sheet; the majority of these DTAs are not allowable for capital purposes. Please refer to the Pillar 3 document for further detail.

Total RWAs and Credit risk RWAs have remained flat throughout the year. The Bank's retail RWAs have increased by £0.4bn, but this is offset by reductions in corporate (£0.3bn) and treasury (£0.1bn).

The increase in retail RWAs is driven by the increase in the mortgage portfolio as the Platform book continues to grow. This is partially offset by the continued rundown of the unsecured book.

Corporate exposures continue to reduce with contractual and out-of-cycle repayments, primarily resulting in a reduction in RWAs of £0.3bn. This reduction is spread across the key corporate sectors such as Private Finance Initiative (PFI), Registered Social Landlords (RSLs) and Commercial Real Estate.

Operational risk RWAs reduced in the year, due to the continued reduction in the three-year average gross income of the Bank.

The Group is reporting a CET1 ratio of 22.3% at the end of 2018 (2017: 24.7%). This has decreased due to the reduction in CET1 resources, driven primarily by the loss incurred in 2018. The leverage ratio of 4.7% is broadly in line with the 2017 position.

At 31 December 2018, the Group had CET1 resources post regulatory deductions of £1,128.0m. The Group received an updated Total Capital Requirement (TCR) from the PRA in December 2018. As at 31 December 2018, the Group had Pillar 1 requirements equivalent to 8.0% of total RWAs and an Individual Capital Requirement (ICR) equivalent to 8.69% of total RWAs (10.0% at 31 December 2017). The Group meets the total 16.69% of RWAs (or £843.4m) TCR with a surplus of £284.6m. MREL requirements in 2018 are aligned to TCR.

The Group has a CRD IV buffer requirement of 2.875% of RWAs (or £145.3m) above the TCR, which is higher than 2017 due to an increase in the capital conservation and the counter cyclical buffers. The Group meets this requirement with a surplus to CRD IV buffer of £139.3m.

The Bank holds a deficit position to the PRA Buffer at the end of 2018, but is targeting compliance with this metric by the end of the planning period.

CO-OPERATIVE VALUES AND COMMUNITY

Our values, ethics and community impact

The Co-operative Bank brand is defined by the values and ethics set out in our Ethical Policy, which represents a clear point of difference that has set us apart from our competitors since 1992, when we were the first bank in the UK to launch a customer-led Ethical Policy. This policy outlines the nature of the businesses to which we would provide banking services, and those we would not. Today's policy has evolved through five comprehensive reviews, all of which have been based on consultation with a total of over 320,000 customer and colleague views, resulting in an extension of the policy in 2015. This consultation and collation of views has ensured that the policy reflects aspects of our business, from our impact on the environment, the products and services we offer, our workplace, the relationships we have with suppliers, to the causes we support and our involvement in local communities. This enables us to stay true to our customers', colleagues' and other stakeholders' aspirations to deliver a differentiated ethical banking service. Our commitment to screen every new non-personal account remains a cornerstone of our Ethical Policy, ensuring that we do not lend customers' money to organisations that are in direct conflict with the issues that matter to our customers as outlined in the Ethical Policy.

Supporting our community

Centrepoint partnership

Our partnership with youth homelessness charity, Centrepoint, started in April 2017 with the launch of our mortgage proposition, donating funds for every new product opened. As Centrepoint continues to establish a base within Manchester, our support has expanded to include sponsorship of events, additional product initiatives and customer and colleague fundraising.

Donations from the mortgage product provide funding for Centrepoint's free national helpline, which gives young people access to specialist advice regardless of where they are within the UK.

Centrepoint realised that over one in five of the calls they received to the helpline were from the Greater Manchester region and therefore they decided to open a Manchester branch of the helpline, providing a tailored and specialist service in the city. As well as support through funding, we have also provided advice and guidance to the Centrepoint helpline team to help establish effective processes, particularly around the development of the helpline's live chat service.

In February 2018, we sponsored Centrepoint's annual awards ceremony, celebrating the achievements of seven young people who have been affected by homelessness. Their stories help to raise awareness of the issue and highlight the vital work that Centrepoint carries out to support young people in this vulnerable position.

For the second year running, the Bank sponsored Centrepoint's Manchester Sleep Out, held in November in the iconic Victoria Baths in Manchester. Over £72,000 was raised through the event, with £32,041 raised by colleagues from the Bank who took part which includes £6,300 donated by the Bank through the Charity Boost Fund. The event is another key point in the year to raise awareness of the support Centrepoint provides to young people and how our partnership is helping Centrepoint with their goal to end youth homelessness.

Through our mortgage proposition, last year's current account switching incentive, colleague and customer fundraising we have raised over £1m for Centrepoint since the start of our partnership.

"Since joining Centrepoint in 2018, one of the things I have been most amazed by is the incredible commitment shown to Centrepoint, and the young people we work with, by everyone at The Co-operative Bank. It has been a real privilege to work with an organisation who shares, so deeply, the same values as we do.

In last year's Annual Report, Seyi Obakin, our CEO, wrote about the development of Centrepoint's helpline service; a service that The Co-operative Bank has been instrumental in helping to establish. The Bank's support for this service continued this year in which the helpline saw an increase in call volumes and online contacts; reflecting the growing need for reliable advice and support for this vulnerable group of young people. Again, thanks to The Co-operative Bank, the Manchester branch of Centrepoint's helpline was formally opened in December 2018. Not only does this initiative increase the reach and ability of our helpline team to answer national calls, it also acts as a triage service for our drop-in centre in Manchester, better enabling our face-to-face team to respond in a bespoke way to those young people who arrive in crisis.

I would like to take this opportunity to thank everyone who took part in our Manchester Sleep Out. I know it was a cold and uncomfortable night, but the size of the team and the amount of money raised by staff members highlights the extraordinary commitment throughout the Bank to Centrepoint's vital and life changing work. Thank you.

Centrepoint is exceptionally grateful to The Co-operative Bank, both staff and customers, for its on-going support of the partnership and our combined commitment to end youth homelessness. It has been a pleasure to witness the partnership go from strength to strength during the year and I look forward to another year of highlights as Centrepoint enters its 50th anniversary year- " Di Gornall, Director of Fundraising.

Supporting co-operatives

The Hive - supporting co-operatives to grow through our partnership with The Hive

Supporting the co-operative movement is key to the Group. In 2018, we were pleased to extend our partnership with Co-operatives UK to fund 'The Hive', a unique business support programme run by Co-operatives UK, for people keen to start or grow a co-operative or community enterprise. The Hive launched in 2016 following a £1m three-year sponsorship from the Bank and the extension of our partnership commits ongoing funding and support. Through a range of online resources, advice and training, The Hive is helping to build more and better co-operative businesses across the UK.

Our renewed commitment will ensure that the programme can continue to run until the end of 2020. Since the start of the programme in March 2016 to the end of 2018, 642 groups have benefited from support worth over £300,000 and which has impacted approximately 25,000 people.

Customers whose organisations are considered to be operating in positive sectors accounted for 49% (2017: 50%) of business deposits and 73% (2017: 75%) of business lending. These positive sectors include co-operatives and mutuals, community, charitable, environmental and social organisations and public services.

We remain a supporter of Credit Unions and continue to be the largest provider of banking facilities to this sector in the UK. Around 50% of UK Credit Unions have an account with The Co-operative Bank.

Campaign to tackle the issue of financial abuse with Refuge

The Co-operative Bank remains committed to campaigning for causes which are sometimes overlooked by society. In late 2015, we partnered with domestic abuse charity Refuge to launch the 'My money, my life' campaign, which for the first time shone a spotlight on the scale of the issue of financial and economic abuse in the UK, and the difficulties faced by victims who needed help and support from their bank or building society.

Our campaigning helped raise awareness of this key issue and as a result of our work with UK Finance, in October 2018, we were pleased to be one of eleven UK banks to sign up to a new Abuse Code of Practice on financial abuse for the UK financial services industry. This represents a positive outcome for the 'My money, my life' campaign, which will help to ensure victims get the support they need from banks and other financial services companies.

Since the launch of the 'My money, my life' campaign, the Government has proposed to include economic abuse in the definition of domestic abuse in the forthcoming Domestic Abuse Bill. Recognising economic abuse as a form of domestic abuse in legislation will have a significant effect on raising awareness and understanding of this form of abuse.

Women in Finance

We signed the Women in Finance Charter in 2016 and at the time the number of women in senior roles was 32%. We set a target to meet 40% by 2020 and due to our focused work on gender diversity, in particular for internal promotions, we are on track to meet this target.

We have a robust five-point gender plan in place to help drive change and to focus on continuing to create an inclusive and diverse culture.

We are starting to see demonstrable results from the actions we have taken to deliver on our Charter commitments. At the end of 2018, the number of women in senior roles had increased by 4% since we set the target in 2016.

Everyday Rewards

Our Everyday Rewards scheme gives eligible current account customers the option to donate their monthly earned rewards to one of five charity partners. These customer donations raised almost £280,000 in 2018, with Amnesty International and Refuge receiving over 50% of the donations.

In total, over £0.5m has now been donated to these charities since Everyday Rewards was launched in 2017.

Supporting our North West community

In 2018, Bank colleagues spent almost 4,330 hours volunteering within our local communities. This is slightly lower than in 2017 (6,080 hours) as employee numbers have reduced. However, 89 team activities took place which is comparable to 2017 (88 activities), demonstrating the ongoing commitment to supporting local charities and community organisations.

Colleagues also supported their local communities through fundraising for charities and local causes. £79,563 has been raised by colleagues, which includes the amount raised for the Centrepoint Sleep Out. £19,000 was donated through the Bank's charity boost fund which tops up colleague fundraising donations by an additional £100 for individual and £400 for team activities. In total, charitable donations made by the Bank, including Everyday Rewards donations, colleague fundraising and corporate donations were £831,224 in 2018.

We have also raised funds and volunteered for the Trussell Trust's operations in Stockport, Skelmersdale and Leek. Colleagues from these locations worked together to hold fundraising events, raising a total of over £4,500. Colleagues have also spent over 200 hours volunteering for the Trussell Trust.

As a major employer in Manchester and the North West of England, we are committed to playing our part in the communities we serve. In 2018, we supported a number of key community events. For the third consecutive year, the Bank supported the Manchester Pride Parade in August, demonstrating our ongoing commitment to diversity and inclusion.

During a three month period over the summer, the Bank participated in the Bee in the City, a major public art trail that spanned Greater Manchester. Almost 700,000 people actively engaged with the art trail, increasing footfall across the city by over 13%. The economic impact has been assessed at £33.5m and over £1.1m was raised for the We Love MCR Stronger Communities Fund through the auction of the bees at the end of the event.

We took on the role of headline sponsor of Hits Radio Live - a community concert bringing some of the biggest music stars to the heart of Manchester, sponsored the 2018 Social Audit Network conference in October, a not-for-profit organisation facilitating the exchange of information between social auditors and the charity and voluntary sector and sponsored and attended The Northern Power Futures event - a two-day festival with guest speakers, practical panels and interactive workshops focused on work, community, culture, lifestyle and wellbeing. The event was attended by Andy Burnham, Mayor of Manchester and young people from across the North West.

We reinforced our commitment to equality and inclusion as community sponsor of the Manchester Diverse City Dinner, in October. This event was part of the Diversity Project, an initiative championing a more inclusive culture within the savings and investment profession. We supported excellence among fledgling small and micro businesses in the North West through our sponsorship of the 'Small Business of the Year Award' at the Northern Soul awards in November, which celebrate and reward cultural and entrepreneurial excellence in the North of England.

Vulnerable customer support

Citizens Advice Manchester

At The Co-operative Bank, we are committed to supporting vulnerable customers and have been working in partnership with Citizens Advice Manchester since 2016 to provide support services to our most vulnerable customers. The aim of the partnership is to ensure that customers can quickly access responsive services that will assist them in addressing immediate financial difficulties and support them to manage their finances in the long term.

Since the launch, we have helped over 1,200 customers deal with over 2,800 problems ranging from debt advice, housing and benefit issues to getting access to food. Within this, we have helped 25 customers to stop them from losing their home. We have also helped customers with £730k of debt, whilst helping customers increase their income.

"Citizens Advice Manchester are delighted that our partnership with The Co-operative Bank continues to develop. Together, we have helped over 1,200 customers get the help they need to get their lives back on track.

Providing customers with direct access to advice means they are better able to keep their homes and family secure. Our holistic approach ensures that customers access other local services."

Hayley Hughes, Business Development Manager, Citizens Advice Manchester

Environmental

Environmental protection and greenhouse gas (GHG) reporting

Protecting the environment (including tackling climate change) is one of the key commitments of our customer-led Ethical Policy. We continued to source the majority of our electricity from renewables in 2018, and maintained our 'beyond carbon neutral' status for the tenth consecutive year, offsetting our operational GHG emissions plus an extra 10% to address the impact our business has had on historical CO_2 emissions. We do this by supporting carbon reduction projects, identified through climate and development experts ClimateCare.

As well as offsetting our carbon emissions, these projects provide additional benefits for people and the environment around the world. One example is our support for a project that has made insulated and efficient Gyapa cookstoves available to 4.1m people in Ghana, saving them more than $84m in fuel costs and generating 2m tonnes of CO_2 emission savings. As well as helping to protect Ghana's dwindling forests, the project also creates jobs and helps people develop valuable skills.

We have reported our GHG emissions for more than ten years, measured in carbon dioxide equivalent (tCO_2e) using the UK Government guidance. Our direct GHG footprint encompasses energy consumption, refrigerant leakages from our premises and all business travel (air, rail and road).

Total GHG emissions by source

	Total emissions (tCO_2e)	
Source of emissions	**2018**	2017
Fuel combustion	**915**	1,804
Electricity consumption [1,2]	**7,230**	12,497
Refrigerant leakages [3]	**650**	397
Business travel	**671**	790
Total	**9,466**	15,488
Carbon intensity (tCO_2e/FTE) [4]	**2.9**	4.2

1. If electricity from renewable sources is accounted as zero carbon then emissions from electricity would be 162 tCO_2e.
2. GHG emissions per unit of electricity are calculated by DEFRA and updated annually.
3. Refrigerant gas data includes major occupancy properties only.
4. Average number of full time equivalent (FTE) employees for the year.

Modern slavery and human trafficking statement

We are committed to ensuring that our business, and our suppliers, are free from modern slavery and human trafficking, upholding the principles of our Ethical Policy. Our Modern Slavery and Human Trafficking statement sets out the steps we are taking to prevent modern slavery and is published on our website (http://www.co-operativebank.co.uk/aboutus/ourbusiness/Human-Trafficking-Statement).

This strategic report was approved by the Board on 27 February 2019 and signed on its behalf.

By order of the Board for The Co-operative Bank Holdings Limited

Robert Dench
Chairman
27 February 2019

By order of the Board for The Co-operative Bank plc

Robert Dench
Chairman
27 February 2019

Corporate Governance

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The information reported in the following pages of the Corporate Governance section reflects the governance arrangements of the Bank Company, with reference to the Holding Company where relevant.

BIOGRAPHIES OF THE BOARD

The biographies of the directors in office at the date of approval of the Annual Report and Accounts are set out below:

Non-Executive Directors

Bob Dench – Chairman
Independent: On Appointment
Committee Membership: Nomination (Chair), Audit, Values and Ethics (Chair)

Bob joined the Bank Board on 1 February 2018 and was appointed as Chairman on 14 March 2018. Bob has enjoyed a long career in banking, and was Chair of Paragon Banking Group plc from 2007 until May 2018, having joined its Board in 2004. He chaired Paragon through the financial crisis and oversaw a reconfiguring of the business model as Paragon obtained its banking licence. Previously, he served on the boards of AXA UK and Ireland from 2004, as Senior Independent Director of AXA UK until December 2016 and Chair of AXA Ireland from 2007 to 2017. He was also Chair of AXA PPP Healthcare Limited from 2013 to 2017. Prior to that, he spent 28 years at Barclays, in a number of senior executive roles across the group in the UK, US and Australia.

Derek Weir – Senior Independent Director
Independent: Yes
Committee membership: Risk (Chair), Audit, Remuneration, Nomination

Derek joined the Bank Board in July 2014 and was appointed Chair of the Risk Committee on 26 January 2016. He was appointed as Senior Independent Director on 5 April 2018. He has over 25 years of financial services experience, holding a range of senior positions in corporate and commercial banking. During this time he held posts, both in the UK and internationally, at Barclays Bank plc and Royal Bank of Scotland plc, including being the Managing Director responsible for Commercial Banking in the UK for Royal Bank of Scotland plc. Derek is currently a Non-Executive Director of Motherwell Football Club Community Trust and a Director of Kerrach Limited. Derek is also Non-Executive Director of Halo Urban Regeneration Company Limited (formerly known as Macklin Enterprise Partnerships Consultancy Limited).

Glyn Smith – Non-Executive Director
Independent: Yes
Committee membership: Audit (Chair), Risk, Values and Ethics

Glyn joined the Bank Board in October 2016, becoming Chair of the Audit Committee on 26 October 2016. He has over 40 years' experience in the financial services sector, most notably in a number of senior executive roles in Barclays Bank and as Group Finance Director of the Portman Building Society. Since 2003, he has held numerous Non-Executive Directorships and chaired the Audit Committees of organisations across both the public and private sectors. These have included Coventry Building Society, Domestic & General Group and Stroud & Swindon Building Society in the financial services sector. Glyn is a Chartered Accountant and a former member of the examinations team of the ICAEW. He is currently also a Non-Executive Director and Chair of the Audit and Risk Committees of Reclaim Fund Ltd and Chair of West Bromwich Building Society Pension Trustees.

William Thomas – Non-Executive Director
Independent: Yes
Committee membership: Remuneration (Chair), Risk, Nomination

William joined the Bank Board in October 2013. He is a former Senior Vice President of Hewlett - Packard and was on the Executive Committee of EDS plc as Executive Vice President. He has IT expertise and is an experienced leader and general manager with a track record in leading major change in large organisations. He has extensive commercial and operational experience, working domestically and internationally with both public and private sector organisations. He is a member of the Council and President of the Alumni Association at Cranfield University School of Management. He serves as the Chair of the Royal Navy and Royal Marines Charity, as the Chair of Spirent Communications plc and as the Chair of Clarkson plc. Additionally, he is an advisor to FireEye Inc, Non-Executive Director and Chair of Chiron Topco Limited (registered in Jersey) and a partner in Hopton Estates.

Paul Copley – Non Executive Director
Independent: No
Committee Memberships: Risk, Remuneration, Nomination

Paul joined the Bank Board on 1 September 2018. He is a highly experienced and recognised specialist in restructuring activities and is a licensed UK insolvency practitioner. As a Partner at PwC he was one of the joint Administrators of Lehman Brothers International (Europe) and had responsibility for derivatives, repo, stock lending and securities portfolios, and agreement of creditor claims for the second largest bank restructuring in history. He stepped down from PwC in 2016 when he joined Kaupthing ehf as CEO. In that role he controlled the realisation of a €3.5bn+ portfolio of pan-European assets which included an Icelandic Retail Bank, operating businesses, real estate and litigation claims.

He is currently CEO and Director of Kaupthing ehf and a Director of Kaupskil ehf. He is also a Director of Aldan Management Limited and a Non-Executive Director of Steinhoff International Holdings NV. He is one of the joint Administrators of Phones 4U Limited.

Christiaan Vogelzang – Non Executive Director
Independent: No
Committee Memberships: Risk, Values and Ethics

Christiaan joined the Bank Board on 1 September 2018. He started his career at Shell, working as a marketer in Europe and Africa. He joined ABN AMRO in 2000, and served in different roles, such as head of Retail Banking and CEO, Global Private Banking. From 2009 until 2017, he was a member of the managing board of ABN AMRO, responsible for Retail and Private Banking. Since 2017, he has been a senior advisor to the Boston Consulting Group, and is a member of several supervisory and advisory bodies. He is also currently a Non-Executive Director of Wolters Kluwer NV.

Executive Director

Andrew Bester – Chief Executive Officer
Andrew joined the Bank Board on 9 July 2018 and assumed full CEO responsibilities from 20 July 2018. He is a banking leader with a track record in business turnaround and large-scale transformation. A qualified chartered accountant, whose career began with three years at PwC and subsequently three years at Deloitte, Andrew joined Standard Chartered Bank in 2004, where he held senior leadership roles in wholesale banking in Africa and Asia. In 2008, he took on the role of Chief Financial Officer for Standard Chartered's Consumer Banking division, and in 2011, he was appointed Chief Operating Officer for Consumer Banking. In his role as a Group Director and Chief Executive of the Commercial Banking division of Lloyds Banking Group, he led the successful customer-focused turnaround and transformation of the commercial/wholesale banking business over five years from 2012. He also led on inclusion and diversity for Lloyds Banking Group, and has multiple awards for his work, including 'Advocate of the Year' at the 2017 Women in Finance Awards.

DIRECTORS' REPORT

The Directors of The Co-operative Bank Holdings Limited and The Co-operative Bank plc (the Directors) present their report and audited accounts for the year ended 31 December 2018.

The Co-operative Bank Holdings Limited (Registered number 10865342) and The Co-operative Bank plc (Registered number 00990937) and its subsidiaries provide a range of banking and financial services in the United Kingdom. See page 11 for a full description of our business model and focus.

Dividends

The Directors do not recommend payment of a dividend for 2018 and do not expect to pay dividends in the near future.

Business review, future developments, post balance sheet events and financial risk management objectives and policies

The business review and future developments, key performance indicators, principal risks and uncertainties are referred to in the strategic report or the information on pages 3 to 5. Financial risk management objectives and policies can be found as detailed below:

	Page
Detailed financial review	12
Risk management objectives and policies	61
Principal risks and uncertainties	63

Post balance sheet events

On 11 February 2019, a Group reconstruction was completed in readiness for issuing MREL debt in 2019 and beyond. The objective of the Group reconstruction was to achieve structural subordination in order that any debt issued from a new intermediary holding company will meet MREL criteria. More information is provided in note 35 to the consolidated financial statements.

Going concern

The assessment of the appropriateness of the going concern basis of accounting for The Co-operative Bank Holdings Limited and The Co-operative Bank plc Annual Report and Accounts 2018 has been subject to thorough consideration involving analysis and discussion by management, Executive and Board Committees and the Board, in line with our governance process.

The Directors have assessed the going concern status using a framework focusing on forecast capital, liquidity and profitability as set out within the Group's strategic plan for 2019-2023 (the Plan). The Directors have also considered the actual versus planned performance for 2018, in addition to any other relevant and material information. After making enquiries of management and considering the Plan, in particular for the 12 month period following the date of approval of the Group and Bank's financial statements, the Directors have a reasonable expectation that the Group and 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. For more details see note 1.3 to the consolidated financial statements.

Political donations

There is a policy that no donations are made for political purposes.

Directors' details

Details of Directors, including appointments and resignations during the financial year, and changes since the end of the financial year are provided on pages 32 to 33 of the Corporate Governance Report. Details of the Directors offering themselves for election and re-election at the 2019 Annual General Meeting are provided on page 33.

Directors' third party and pension scheme indemnity provisions

Details of insurance and indemnities in place for the benefit of the Directors are provided within the Corporate Governance Report.

Related parties

Details of related party transactions are set out in note 31 to the consolidated financial statements, note 22 to the Bank Company financial statements and note 5 to the Holding Company financial statements

Corporate responsibility

Corporate responsibility activities are outlined on page 20.

CO_2 emissions

The Greenhouse gas emissions report is detailed on page 22.

Anti-bribery and corruption

Based upon the business activity, strategy and UK focus of the Group, it is assessed as being an inherently low risk organisation in terms of bribery and corruption. For 2018, there are no anti-bribery matters to disclose and no material risks have been identified. The Group has a comprehensive Anti-Bribery and Corruption Control Standard, part of which requires due diligence on new third party suppliers during the on-boarding process and is supplemented by annual due diligence of existing suppliers. In addition, annual training is provided to all colleagues on their anti-bribery and corruption obligations.

Our people
Following our successful recapitalisation in 2017, we have strengthened our workplace values and behaviours and have continued to embed these throughout the business during 2018; recognising they are essential for us to deliver our strategic plan successfully. We continue to ensure that we build the right culture for our Group, for both colleagues and customers. Our CEO and the Executive Team are focused on building and embedding a values-led culture with the customer at the forefront of our thinking.

Our annual engagement survey results (October 2018) confirm that our people remain highly engaged (80%) with the Bank, its strategy and its leadership. Significantly our overall score is 12 points above external industry benchmarks, demonstrating continued strong progress since 2014. While these scores are encouraging, we continue to use insight gained from the survey to build on this progress through 2019 and beyond.

Leadership and succession planning
Great leadership is integral to sustaining the right culture and we have renewed our focus on leadership capability in 2018 with the launch of our Growing Great Leadership programme, which brought our leadership team together to share best practice and ensure a common understanding of what great leadership is. 60 of these leaders are also participating in a structured development programme to build their leadership skills further; supporting us to have strong development and succession plans in place for the future.

Identifying and developing emerging talent is a key focus for us and our graduate programme is integral to this. We currently have 30 colleagues on our graduate scheme, and in 2018 eleven of our graduates finished their three-year programme and were successful in securing permanent roles across our business.

Performance and development
Enabling our people to perform at their best is essential to our future success, therefore having a robust and consistent performance management framework is key. In 2018, we have refined our approach to ensure consistency for all colleagues. We know that access to development is essential to support people, but also to build capability and succession. Therefore, we remain focused on supporting the development of our people through the provision of high quality development opportunities, as well as mandatory risk, conduct and performance management training. The mandatory leadership objective, launched from 2018, continues to be included for all people leaders to embed the right culture to reflect our values, and we include a 'New to Leadership' training module for all colleagues moving into leadership roles.

Our apprenticeship offering has also grown during 2018 with over 100 colleagues now taking advantage of programmes across different disciplines.

Inclusion and diversity
We have continued to focus on a range of initiatives to increase diversity and promote inclusion and have seen a number of successes this year including:

- encouraged all colleagues, and women in particular, to take up the opportunities available through our Career Confidence programme and mentoring initiatives;
- supported colleagues who are parents, through parental workshops and mentoring schemes;
- made a difference to our colleagues, customers and communities through our Social Mobility Foundation charity work experience and mentoring programmes and our involvement in Pride LGBT celebrations in Manchester; and
- expanded our colleague inclusion networks with the addition of 'Access' to support colleagues with disabilities, long-term health conditions and caring responsibilities. This is in addition to 'Reach' (our Race, Ethnicity and Cultural Heritage network), sponsored by our CEO. We also renewed our commitments under the Race Charter.

These two new networks, along with Elevate (our women's career network) and Proud Together (our LGBT network), continue to support our inclusion work and make a difference. We are on track with our commitments under HM Treasury Women in Finance Charter. We were one of the first companies to sign up to the Charter in 2016 which supports the progression of women into senior management roles, and we are doing well against our target to achieve 40% representation of women in our senior roles by 2020. We also continue to hold relationships with diversity advisory bodies such as Inclusive Employers who provide the Group with support on inclusion. Our diversity performance can be found over the page.

We are a Disability Confident certified employer and are committed to recruiting and retaining people with disabilities or health conditions for their skills and talent. Under this commitment, interviews are offered to all candidates with a disability who meet the minimum criteria for the role. Policies and processes are in place to support disabled colleagues and we are dedicated to making reasonable adjustments for new colleagues, and for those individuals who develop disabilities whilst in our employment.

In January 2015, as part of our refreshed Ethical Policy, we committed to paying colleagues no less than the real living wage and we have re-affirmed this commitment each year.

Regular informal and formal consultations take place with Unite, our Trade Union. The Union continues to be fully consulted where organisational change and other issues may affect colleagues.

HR key performance indicators

Gender diversity

As at 31 December 2018 (Headcount)	Female No.	Female %	Male No.	Male %
Board[1]	1	13%	7	87%
Executive Management Team[2]	3	25%	9	75%
Other employees	1,966	59%	1,375	41%
Grand total	1,970	59%	1,391	41%

As at 31 December 2017 (Headcount)	Female No.	Female %	Male No.	Male %
Board[1]	1	11%	8	89%
Executive Management Team[2]	2	29%	5	71%
Other employees	2,302	60%	1,546	40%
Grand total	2,305	60%	1,559	40%

1. Board: Includes Executive and Non-Executive Directors.
2. Executive Management Team: Includes senior managers who have responsibility for planning, directing or controlling the activities of the business.

Wellbeing

We recognise that health and wellbeing at work are vital. Wellbeing services include access to an external Employee Assistance Programme (EAP) which provides free expert advice to colleagues on a wide range of matters including health and wellbeing, personal and work-related concerns, money and debt, child/elder care and trauma. The EAP offering to colleagues was improved in 2017 and the support available to colleagues has been regularly promoted in 2018 including forming part of colleague roadshows across different Group locations. Occupational health support is also provided.

Employment and litigation

Employment litigation levels at the Group remain very low. Three tribunal claims were lodged against the Group in 2018, of which two were settled without any, or minimal financial outlay, and the third is being defended.

Senior Managers and Certification Regime (SMCR) and whistleblowing

The Group continues to deliver robust compliance with its governance over the Senior Managers and Certification Regime. The HR, Risk and Legal departments co-ordinate efforts to ensure that regulatory requirements are met, at the same time seeking a smooth process for those impacted by, for example, fitness and propriety checks. Conduct (COCON) Rule compliance is overseen by an independent panel. The Group's whistleblowing oversight is similarly reviewed to ensure that all relevant disclosures are captured and reported, and that whistleblowers are not subjected to detriment. The Group has a nominated whistleblowing champion who is a Board member and deals with all such concerns confidentially whilst ensuring appropriate investigation and follow up procedures are conducted.

Statement of Directors' responsibilities

The Directors are responsible for preparing the Annual Report and Accounts and the consolidated financial statements of The Co-operative Bank Holdings Limited and its subsidiaries (the Group), the consolidated financial statements of The Co-operative Bank plc and its subsidiaries (the Bank) and Parent Company financial statements for The Co-operative Bank Holdings Limited (the Holding Company) and Parent Company financial statements for The Co-operative Bank plc (the Bank Company) in accordance with applicable law and regulations.

Company law requires the Directors to prepare Group, Bank, Holding Company and Bank Company financial statements for each financial year. Under that law they have elected to prepare the Group, Bank, Holding Company and Bank Company financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the EU and applicable law.

Under Company law the Directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Group, Bank, Holding Company and Bank Company and of their income statements for that year. In preparing each of the Group, Bank, Holding Company and Bank Company financial statements, the Directors are required to:

- select suitable accounting policies in accordance with International Accounting Standard 8: Accounting Policies, Changes in Accounting Estimates and Errors and then apply them consistently;
- present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information;
- provide additional disclosures when compliance with the specific requirements in IFRSs as adopted by the EU is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the financial performance; and
- state that the Group, Bank, Holding Company and Bank Company have complied with IFRSs as adopted by the EU, subject to any material departures disclosed and explained in the financial statements.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Group's, Bank's, Holding Company's and Bank Company's transactions and disclose with reasonable accuracy at any time the financial position of the Group, Bank, Holding Company and Bank Company and enable them to ensure that the financial statements comply with the Companies Act 2006. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Group, Bank, Holding Company and Bank Company and to prevent and detect fraud and other irregularities.

The Directors are also responsible for preparing, in accordance with applicable laws and regulations, a strategic report, Directors' report and Corporate Governance statement that complies with that law and those regulations. The Directors are responsible for the maintenance and integrity of the corporate and financial information included on the Group's website.

Legislation in the UK governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Disclosure of information to the auditor

So far as the Directors are aware, there is no relevant audit information of which the Group and Bank's auditor is unaware, and the Directors have taken all steps that they ought to have taken as Directors in order to make themselves aware of any relevant audit information and to establish that the Group and Bank's auditor is aware of that information. We confirm that to the best of our knowledge:

- the financial statements, prepared in accordance with the applicable set of accounting standards, give a true and fair view of the assets, liabilities, financial position and income statement of the Group and Bank and of the undertakings included in the consolidations taken as a whole;
- the strategic report includes a fair review of the development and performance of the business and the position of the Group, Bank, Holding Company, Bank Company and the undertakings included in the consolidations taken as a whole, together with a description of the Principal risks and uncertainties that they face; and
- the annual report and financial statements, taken as a whole, are fair, balanced and understandable and provide the information necessary for shareholders to assess the Group's, Bank's, Holding Company's and Bank Company's performance, business model and strategy.

This responsibility statement was approved by the Board of Directors of the Holding Company and Bank Company on 27 February 2019 and is signed on its behalf by:

By order of the Board for The Co-operative Bank Holdings Limited

Robert Dench
Chairman
27 February 2019

By order of the Board for The Co-operative Bank plc

Robert Dench
Chairman
27 February 2019

CORPORATE GOVERNANCE REPORT

Ownership

The Co-operative Bank plc (Bank Company) is a public limited company with debt securities listed on the London Stock Exchange. Its equity is not listed. It has listed covered bonds with a maturity date of 2021. As at 31 December 2018, the Bank Company's sole shareholder is The Co-operative Bank Holdings Limited (Holding Company), which is a private company limited by share capital.

The Holding Company's share capital is divided into Class A ordinary shares of £0.0001 each and Class B redeemable preference shares of £0.01 each. The A shares are entitled to dividends to be paid out of the profits of the Holding Company, but the B shares do not carry any right to participate in the profits of the Holding Company, except as provided for on a Bank Company exit (any transaction or arrangement which results in the Holding Company ceasing to be the Bank Company's direct or indirect Holding Company or ceasing to hold directly or indirectly substantially all of the assets of the Bank Company) or IPO exit (admission of the A shares of the Holding Company to a securities exchange, as defined in the Articles of Association of the Holding Company (Holding Company Articles)).

On a return of capital on liquidation, dissolution or winding up, the surplus assets of the Holding Company are applied first, in respect of each B share, an amount equal to the nominal value (and if such proceeds are insufficient, allocated between them pro rata to the aggregate amount due to each), and second, the balance remaining (if any) shall be distributed to the A shareholders pro rata by reference to the number of A shares held by them respectively.

No A shareholder is entitled to receive notice of, nor attend to vote at a general meeting of the Holding Company, save where a resolution is to be proposed at such meeting: abrogating or varying any of the rights or privileges attached to the A shares; for the winding up or dissolution of the Holding Company; in respect of the purchase or redemption (save for the redemption of B shares) of any share capital of the Holding Company; or in respect of a Bank Company Exit, or IPO Exit. Each and every B shareholder is entitled to receive notice of, attend and vote at a general meeting of the Holding Company, with one vote in respect of each B share registered in the name of the holder.

Member Matters (as defined in the Bank Company's Articles of Association) may only be taken by the Board of the Bank Company, with the approval of the Holding Company by ordinary resolution.

B shareholder Matters (as defined in the Holding Company Articles) may only be undertaken by the Board of the Holding Company, or approved for implementation at Bank Company level, with the prior written approval of the holders of more than 50% of the B shares in issue.

The B shareholders are entitled to appoint up to two Directors to the Board of the Holding Company, and the Holding Company is entitled to appoint up to two Directors to the Board of the Bank Company, who are designated as B Directors of the Holding Company and the Bank Company. The B Directors are Paul Copley and Christiaan Vogelzang.

On 1 September 2017, the Holding Company and the B shareholders (as set out in Schedule 1 to the B Shareholders Agreement, and any person who executes a Deed of Adherence in the form set out in Schedule 2 to the B Shareholders Agreement) entered into a B Shareholders Agreement for the purpose of setting out the Exit Premium principles in accordance with the Holding Company Articles. Subject to other provisions of Holding Company Article 12, if at any time an A shareholder (together with its affiliates):

- is the registered holder of equal to or greater than, 10% of the A shares then in issue (the B Threshold);
- has been and is approved by the PRA as a Controller of the Holding Company; and
- executes a deed of adherence to the B Shareholders' Agreement, together the 'Qualifying Conditions',

such A shareholder shall be deemed a 'Qualifying Shareholder' and the Holding Company shall have the power to allot and issue to them, one B share for every 1% held of the A shares then in issue (rounded down to the nearest whole percentage point).

As at 27 February 2019, the B shareholders of the Holding Company (and their percentage B shareholding) were: Anchorage Illiquid Opportunities Offshore Master V.L.P (24.10%); SP Coop Investments, Ltd (22.89%); Goldentree Asset Management Lux S.A.R.L. (16.87%); Cyrus Opportunities Master Fund II, Ltd (12.05%); Invesco Asset Management Limited for and on behalf of its discretionary managed clients via The Bank of New York Nominees Limited (12.05%); and Blue Mountain Cayman SP for and on behalf of Balloon SP (12.05%).

On 11 February 2019, The Co-operative Bank Finance Limited (Issuer company), became the immediate parent of the Bank Company, with Holding Company remaining the ultimate parent company of the Bank Company. See note 35 to the consolidated financial statements for further details.

Corporate Governance Statement

The revised UK Corporate Governance Code was published by the Financial Reporting Council in July 2018 (the 2018 Code). The Group has reviewed it, and is comfortable that its Corporate Governance framework reflects many of the principles and provisions set out in the 2018 Code, even though the Group is not required to comply with the 2018 Code.

The Directors recognise the need for sound Corporate Governance arrangements at all levels of the Group and continue to review, as required, the Group's governance arrangements to ensure that the necessary high standards are promoted, paying particular attention to The Companies (Miscellaneous Reporting) Regulations 2018 (the Corporate Governance Regulations) which come into effect for accounting periods beginning on or after 1 January 2019.

Values and ethics
Under the Holding Company's and Bank Company's Articles of Association, there is a requirement for the Holding Company and Bank Company to promote and conduct its business to the extent practicable, in a manner informed by the established values of the co-operative movement, in particular with regard to:
- how it relates to, communicates with, balances the interests of, and otherwise deals with its stakeholders; and
- how it applies the profits of the Bank, in accordance with the dividend policy set out in its Articles of Association.

Role and responsibilities of the Board of the Holding Company and the Board of the Bank Company
The Boards have collective responsibility for the long-term success of the Holding Company and Bank Company. Their role is to provide leadership within a framework of prudent and effective controls which enable risk to be assessed and managed. They set the values and standards and ensure that their obligations to shareholders, customers, employees and other stakeholders are understood and met.

The Board of the Bank Company sets the Bank's strategy and approves plans presented by management for the achievement of the strategic objectives it has set. It determines the nature and extent of the principal risks it is willing to take to achieve its strategic objectives, and is responsible for ensuring maintenance of sound risk management and internal control systems.

The Board and shareholders have approved a schedule of Matters Reserved for the Board and authorities delegated to the CEO. Both the Matters Reserved for the Board and the CEO's delegated authorities have been revisited by the Board and have been re-adopted for 2019 with appropriate adjustments. Implementation of the strategy set by the Board of the Bank Company and the management and day-to-day running of the Bank is delegated to the CEO, with oversight by the Board, with the exception of the Matters Reserved for the Board.

Board composition
During the year, there have been changes to the Board of the Holding Company and to the Board of the Bank Company (the Boards). Details of the members of the Boards, their biographies and details of length of service are set out from page 25.

Bob Dench joined the Boards as a Non-Executive Director on 1 February 2018 and became Chairman of both Boards on 14 March 2018, succeeding Dennis Holt. Andrew Bester joined the Boards as an Executive Director on 9 July 2018 and assumed full CEO responsibilities from 20 July 2018. Laura Carstensen stepped down from the Boards on 31 December 2018.

All the Non-Executive Directors have considerable experience and make valuable contributions to the Group. The Non-Executive Directors constructively challenge and help to develop proposals on strategy and bring strong, independent judgement, knowledge and experience to the Boards' deliberations.

The Non-Executive Directors are of sufficient calibre and number such that their views carry significant weight in the Boards' decision making.

Board changes
During 2018, four Directors were appointed to the Boards of the Holding Company and the Bank Company, and six Directors stood down from these Boards.

Current members of the Boards		Independent	Appointed (Holding Company)	Appointed (Bank Company)
Bob Dench	Chairman	On appointment to the Board	1 February 2018	1 February 2018
Derek Weir	Senior Independent Director	Independent	1 September 2017	25 July 2014
William Thomas	Non-Executive Director	Independent	1 September 2017	28 October 2013
Glyn Smith	Non-Executive Director	Independent	1 September 2017	10 October 2016
Paul Copley	Non-Executive Director	Not Independent	1 September 2018	1 September 2018
Christiaan Vogelzang	Non-Executive Director	Not Independent	1 September 2018	1 September 2018
Andrew Bester	Chief Executive Officer	N/A	9 July 2018	9 July 2018

Members of the Boards stepping down since 1 January 2018		Independent	Appointed to Holding and (Bank) Company Boards	Ceased to be a Director of these Boards
Dennis Holt	Chairman	On appointment to the Board	1 September 2017 (3 February 2014)	14 March 2018
Aidan Birkett	Senior Independent Director	Independent	1 September 2017 (1 July 2015)	14 March 2018
Charles Bralver	Non-Executive Director	Not Independent	1 September 2017 (23 April 2015)	31 August 2018
Laura Carstensen	Non-Executive Director	Independent	1 September 2017 (27 May 2014)	31 December 2018
Liam Coleman	Chief Executive Officer	N/A	13 July 2017 (11 July 2016)	20 July 2018
Tom Wood	Chief Financial and Restructuring Officer	N/A	13 July 2017 (1 September 2017)	9 October 2018

Appointment and Reappointment of Directors

All Non-Executive Directors are appointed to the Boards for an initial term of three years but, under the terms of their appointment, are required to submit themselves for annual re-election at the Holding Company's and Bank Company's Annual General Meetings (AGMs). All Directors will offer themselves for election or re-election at the AGMs in 2019. The terms of appointment of the Non-Executive Directors are available for inspection on request to the Secretary.

The biographical details of all Directors are discussed on pages 25 to 26 and can also be found on our website at: www.co-operativebank.co.uk/aboutus/governance/Directors

Attendance

The following table sets out the attendance at the scheduled Holding Company and Bank Company Board and Committee meetings during 2018:

Attended[1] (entitled to attend)[2] Name	Board	Audit Committee	Risk Committee	Values and Ethics Committee	Remuneration Committee	Nomination Committee
Dennis Holt	3 (3)	4 (4)		2 (2)		1 (1)
Bob Dench	10 (10)	7 (7)		2 (2)		6 (7)
Aidan Birkett	2 (3)	3 (4)			2 (3)	0 (1)
Laura Carstensen	9 (11)		4 (6)	4 (4)	4 (6)	
Derek Weir	11 (11)	8 (8)	9 (9)		6 (6)	5 (6)
Glyn Smith	11 (11)	8 (8)	9 (9)	4 (4)		
William Thomas	11 (11)		9 (9)		6 (6)	7 (7)
Charles Bralver	7 (7)		7 (7)	2 (3)	3 (5)	4 (5)
Andrew Bester	6 (6)					
Liam Coleman	5 (5)					
Tom Wood	7 (7)					
Paul Copley	4 (4)		2 (2)		1 (1)	2 (2)
Christiaan Vogelzang	4 (4)		2 (2)	1 (1)		

1. Business as usual scheduled meetings.
2. The Director concerned was entitled to attend because he/she was a member of the Board or Committee at the time of the meeting.

Number of Holding Company and Bank Company Board and Committee meetings in 2018

Board meetings (scheduled):	11
Audit Committee meetings:	8
Risk Committee meetings:	9
Values and Ethics Committee meetings:	4
Remuneration Committee meetings:	6
Nomination Committee meetings:	7

Where Directors are unable to attend Board meetings, usually for reasons of illness or a requirement to hold these at shorter notice than is usual, the Chairman encourages Directors to provide their views, questions and comments directly to him.

In addition to the above scheduled Board meetings there were eight ad-hoc meetings to support strategic and other ad-hoc matters.

Information to Directors

Directors and usual attendees of Board and Committee meetings, use a Board portal and an electronic tablet as their primary method for the receipt of papers. The electronic tablet provides access to additional materials to support Directors in their preparations for Board and corporate activity, including constitutional documents and the materials from previous meetings.

In the ordinary course of scheduled Board and Board Committee meetings, the aim is to provide the Directors with access to Board and Committee papers seven days before a meeting.

Board Committees

The Boards have established Board Committees, namely; the Audit Committees, the Risk Committees, the Values and Ethics Committees, the Remuneration Committees and the Nomination Committees.

All Board committees have Terms of Reference, describing the authority delegated to it by each Board. Each of these Committees has a role in ensuring the effective oversight by the Boards of the Holding Company, the Bank Company and their subsidiaries.

The Terms of Reference for the Bank Company's Audit Committee, Risk Committees, Values and Ethics Committee, Remuneration Committee and Nomination Committee can be found at www.co-operativebank.co.uk/aboutus/governance/terms-of-reference-for-Board-Committees.

The Company Secretary maintains the Holding Company's Terms of Reference. They are not published on a website but are available to relevant stakeholders.

The Boards receive the minutes of all Committee meetings. During the year, each of the Committees reviewed its Terms of Reference.

Information on the Committees can be found on the following pages:

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Audit Committee	35
Values and Ethics Committee	41
Risk Committee	44
Nomination Committee	47
Remuneration Committee	51

AUDIT COMMITTEE REPORT

The Audit Committee (the Committee) continues to provide oversight and informed challenge over the systems of financial reporting and control, accounts preparation and internal and external audit processes. Areas of particular focus have been the implementation of International Financial Reporting Standard 9 (IFRS 9), continued improvements to the systems of financial reporting and control, the determination of any remaining provisions for Payment Protection Insurance (PPI) and other conduct related issues arising from prior years, the accounting and taxation treatment of the defined benefit pension schemes, hedge accounting and the valuation of the Surrendered Loss Debtor. Through the work of Internal Audit, the Committee has continued to provide oversight of the embedding of the Risk Management Framework (RMF). It also oversees the Concern at Work (Whistleblowing) arrangements.

Glyn Smith
Audit Committee Chair
27 February 2019

Purpose of the Audit Committee

To monitor, review and report to the Board and its sole shareholder on the formal arrangements established by the Board in respect of the financial and narrative reporting of the Group, the internal controls and the RMF, the internal audit and the external audit processes.

Audit Committee membership	Date of appointment	Date of resignation
Glyn Smith (Chair)	Appointed 10 October 2016 Chairman since 26 October 2016	
Derek Weir	Appointed 9 December 2014	
Aidan Birkett	Appointed 23 September 2015	Resigned 14 March 2018
Dennis Holt	Appointed 26 September 2017	Resigned 14 March 2018
Bob Dench	Appointed 14 March 2018	

Glyn Smith retained the Chairmanship of the Committee throughout the year. Dennis Holt and Aidan Birkett stepped down from the Committee on 14 March 2018 and Bob Dench joined the Committee with effect from the same date. Meetings of the Committee are generally attended by the Chief Executive Officer, Chief Financial Officer, invited members of the Finance and Risk teams and the Director of Internal Audit, none of whom attends as of right. The external auditor attends Committee meetings, and private meetings are held with internal and external auditors and with the risk function as necessary to afford them the opportunity of discussions without the presence of management. The Committee met eight times during the financial year. The Chairman of the Committee reports back to the Board on the outcome of meetings and the Board receives the minutes of all Committee meetings.

Alignment with Risk Committee

The Committee recognises the common interest in issues relevant to both Committees. To support the co-ordination of information between the Committees, the Chair of each of the Audit and Risk Committees is a member of both Committees. Both the Audit Committee and Risk Committee welcome attendance by representatives of internal audit and the external auditor at their meetings.

Principal responsibilities and key areas of discussion of the Committee on behalf of the Bank

Principal responsibilities of the Audit Committee	Key areas discussed and reviewed by the Committee in 2018
Financial and narrative reporting	
• Review the content of the Annual Report and Accounts and advise the Board on whether, taken as a whole, it is fair, balanced and understandable and provides the information necessary for shareholders to assess the performance, business model and strategy; • Monitor the integrity of the financial statements; and • Review and challenge where necessary: o the consistency of, and any changes to, significant accounting policies both on a year-on-year basis and across the financial statements; o the methods used to account for significant or unusual transactions where different approaches are possible; o whether appropriate accounting standards have been followed and appropriate estimates and judgements made, taking into account the views of the external auditor; o the assumptions or qualifications in support of the going concern statement; o the clarity and completeness of disclosure in the Group and Bank's financial reports and the context in which statements are made.	• The Committee allocates a number of meetings in its calendar to focus on the preparation for and review of the Annual Report and Accounts. During 2018, the review process included a detailed review of significant accounting judgements and accounting policies and regular dialogue with the external auditor. The Accounting Policy Forum reviews all accounting policies for significant transactions and the Key Judgements Forum reviews, challenges and approves all key judgements and associated journal postings. The Committee received regular updates relating to decisions made at the Key Judgements Forum. The Committee also reviews the Annual Report and Accounts process to ensure that financial reporting risk is adequately managed; • Key judgements discussed as part of the 2018 accounts process are detailed on page 38, including reports by the external auditor throughout the year; • The Board receives a report from the Audit Committee prior to the Board meetings which considers the content of the Annual Report and Accounts. Compliance with accounting standards and the completeness of disclosures are also discussed; • The Committee received regular updates on the implementation of IFRS 9 and considered its impact on the Annual Report and Accounts; and • The Committee reviewed and challenged the quarterly financial reports for Q1, Q2 and Q3 2018 and recommended them to the Board for onward circulation to the sole shareholder.
Internal controls and risk management systems	
• Review the adequacy and effectiveness of internal financial controls and internal control and risk management systems and statements in the Annual Report concerning internal controls and risk management. • Review the Bank's arrangements for the deterrence, detection, prevention and investigation of fraud and receive and consider special investigation reports relating to fraud or major breakdowns in internal controls or major omissions including remedial action by management.	• During 2018, the Audit Committee considered the recommendations of Internal Audit and the external auditor in respect of internal control mechanisms and monitored progress against those recommendations. Both the Director of Internal Audit and the Chief Risk Officer attended Audit Committee meetings throughout the year; and • During 2018, the Committee considered reports on Risk Management, Internal Controls and other reports from management, in relation to the Bank's risk management framework, or in relation to the annual report and accounts.
Raising a Concern at Work (Whistleblowing)	
• Review the adequacy and security of the arrangements for employees and contractors to raise concerns, in confidence, about possible wrongdoing in financial reporting or other matters and annually review and approve the Bank's Raising a Concern at Work (Whistleblowing) Policy; and • Annually review the Concern at Work events report.	• The Committee received regular updates on incidents reported under the Bank's Raising a Concern at Work (Whistleblowing) Policy. In November 2018, the Committee carried out an annual review and re-approval of the Policy; and • During 2018, the Committee reviewed the annual Raising a Concern at Work report from Compliance and Financial Crime, which considered the Bank's Code of Conduct and associated mandatory training, including fraud awareness training, and which also included a review of the Bank's arrangements, resulting in extending the Policy to apply to any person who reports a concern, not just current or former staff and third party suppliers.
Terms of Reference	
• Review the Committee's Terms of Reference and monitor its execution.	• The Committee conducted an annual review of its Terms of Reference and reviewed its deliveries against these.

Principal responsibilities of the Audit Committee	Key areas discussed and reviewed by the Committee in 2018
Internal audit	
• Approve the appointment or termination of appointment of the Director of Internal Audit; • Review and approve the Charter of the Internal Audit function and ensure that the function has the necessary resources and access to information to enable it to fulfil its mandate, has unrestricted scope and is equipped to perform in accordance with appropriate professional standards for internal auditors; • Ensure the Director of Internal Audit has direct access to the Chairman of the Board and to the Chairman of the Committee, and is accountable to the Committee, ensuring that Internal Audit is independent of the Executive and able to exercise independent judgement; • Review and assess the annual internal audit work plan and the reasons for any significant change or delay to this plan, ensuring that it includes the evaluation of the effectiveness of the risk, compliance and finance functions; • Receive reports on the results of the internal auditor's work; • Review and monitor management's responsiveness to the internal auditor's findings and recommendations; • Meet with the Director of Internal Audit at least once a year without the presence of management; and • Monitor and review the effectiveness of the Bank's Internal Audit function, in the context of the overall risk management system and consider whether an independent, third party review of Internal Audit effectiveness and processes is appropriate.	• The Committee received and considered the results of the Internal Audit annual self-effectiveness review, which included Internal Audit's view of the control environment, its assessment of key risks, delivery of internal audit reports, control theme monitoring and issue assurance; • In accordance with the Bank's Internal Audit Charter, an external assessment is conducted at least every four years, and an independent review was conducted by Independent Audit Limited in 2016. A limited scope review was completed during 2018 by PricewaterhouseCoopers LLP (PWC), focussing on the structure, budget and work plans of the Internal Audit team, the results of which were presented to the Committee for their review and comment. No material findings were raised; • During 2018, the Committee also provided its own review and challenge of the Internal Audit Charter, the resources of the function and the plan of activities taking place during the year; • The Committee considers Internal Audit activity reports covering key thematic risks; • The Committee receives all 'red' rated Internal Audit reports and invites management to present findings and remedial actions; • The 2019 Internal Audit plan is due to include evaluation of the effectiveness of the risk, compliance and finance functions; and • During the year, in camera sessions were held with the Director of Internal Audit.
External audit	
• Consider and make recommendations to the Board, to be put to shareholders for approval at the AGM, in relation to the appointment, reappointment and removal of the external auditor; • Ensure that at least once every ten years the audit services contract is put out to tender and oversee the selection process; • If an auditor resigns, investigate the issues leading to this and decide whether any action is required; • Oversee the relationship with the external auditors and review the findings of the audit with the external auditor; • Approve their remuneration including fees for both audit and non-audit services; • Develop and implement policy on the supply of non-audit services by the external auditor specifying the types of non-audit service for which use of the external auditor is pre-approved and the requirement to authorise provision of any non-audit services by the external auditor to avoid any threat to auditor objectivity and independence, taking into account any relevant ethical guidance on the matter. Reporting of the use of non-audit services should include those subject to pre-approval; • Annually assess their independence and objectivity; • Review any representation letter(s) requested by the external auditor before they are signed by management; • Review the management letter and management's response to the auditor's major findings and recommendations; and • Meet regularly with the external auditor and at least once a year without the presence of management.	• The Committee recommended the re-appointment of Ernst & Young LLP (EY) to the Board and the sole member at the Annual General Meeting; • The Committee liaised closely with the external auditor in respect of their views on the most significant of the key accounting judgements and findings; • The Committee reviewed the external audit plan; • In the course of making a recommendation to the Board in respect of representations to the auditor, the Committee reviewed and challenged management assurances supporting management representation letters to the external auditors; • The Committee considered the external auditor's management letter containing observations arising from the annual audit leading to recommendations for control or financial reporting improvement and monitored progress; • The Committee reviewed and approved the policy for the supply of non-audit services by the external auditor in February 2019 and approved the 2018 fees for audit and non-audit services; • The Committee reviewed the independence of the external auditors and the objectivity of the audit engagement partner and audit staff using self-assessments from the external auditor and based on a review conducted by Internal Audit to review the independence and objectivity of the external auditor and their effectiveness, which the Committee considered in March 2018; • The Committee reviewed the Financial Reporting Council's (FRC) Audit Quality Review of EY's audit of the Bank for the year ended 31 December 2016 which became available during the year.

During 2018, the Audit Committee of the Holding Company recommended the Annual Report and Accounts and quarterly financial reports to its Board and reviewed, monitored and challenged policies, transactions and reports (including Internal Audit reports) in accordance with its Terms of Reference.

1. Significant accounting matters considered by the Committee

In relation to the 2018 financial statements, the Committee considered the following significant accounting issues, matters and judgements. The disclosure and presentation of these matters were discussed and debated with management and the external auditors (EY).

1.1 Going concern

The Group has recently approved its 2019-2023 Financial Plan (the Plan) and has used this as the basis of its assessment in evaluating whether adopting the going concern basis of accounting is appropriate for the Group, Bank, Holding Company and Bank Company. This includes a detailed review of projected profitability, forecast liquidity position, capital ratios and regulatory capital considerations. Appropriate consideration has also been given to the 2019 budget and how this compares to the 2018 performance and the principal risks and uncertainties that could impact future performance. The Plan also documents both a route to profitability and to full regulatory compliance.

The assessment of the going concern basis of preparation 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.

The Committee considered and recommended to the Board that the going concern basis of accounting be adopted, and the disclosures prepared by management form part of note 1 to the consolidated financial statements.

1.2 Impairment of loans and advances to customers

The Committee reviewed detailed papers prepared by management covering the drivers for changes to impairment provisions which include, as in previous years, the emergence period and probability of default, governance and controls over the provisions and substantive evidence supporting model parameters and appropriate post model adjustments. There have been significant changes to the assessment of impairment provisions in 2018 due to the IFRS 9 accounting standard coming into effect from 1 January 2018. The Committee was regularly updated as to the implementation of IFRS 9 and the impact this has had on the impairment provisions. The Committee also carefully considered evidence in the post balance sheet period as to whether additional provisions were required relative to conditions existing at the balance sheet date.

1.3 Conduct risk and legal provisioning

The Committee considered recommendations from management regarding conduct risk and legal provisioning, and considered the underlying assumptions for the population affected, size of potential redress and customer complaints received. Detailed papers were presented outlining the key judgements used and these were debated and challenged by the Committee. As well as the ongoing oversight throughout the year, the Committee discussed an overview of the key assumptions and judgements made by management in determining appropriate year end conduct and legal provisions.

1.4 Fair values of financial assets and liabilities

Management presented a paper on the basis of preparation and calculation of note 33 to the consolidated financial statements and note 24 to the Bank Company financial statements and concurred with the note disclosure.

1.5 Effective interest rate

Management presented a paper to provide an overview of how effective interest rate (EIR) accounting is applied and the impacts on the financial statements over recent years. Management also outlined how behavioural assumptions and economic assumptions impact the EIR asset.

1.6 Pensions

The Committee considered the accounting treatment of both of the principal pension schemes, Pace and Britannia. Sectionalisation of the Pace pension scheme was completed in August 2018 and it was concluded that, as at June 2018, sufficient information was available to reliably account for the Pace pension scheme as a defined benefit scheme. The key judgements also considered by the Committee include the ability of the pension surplus to be recognised on balance sheet, the accounting for GMP equalisation and the pension assumptions adopted.

1.7 Surrendered loss debtor

The Committee discussed the measurement of the Surrendered Loss Debtor (SLD) due from Co-operative Group in relation to previous losses surrendered, and reviewed a paper prepared by management setting out the key assumptions inherent in the calculation and the basis and rationale for such assumptions. The key judgements associated with the calculation of the SLD include assumptions about Co-operative Group's capacity to realise the benefit of the tax losses surrendered, the accuracy of the repayment profile information provided by Co-operative Group, the extrapolation of the repayment profiles provided by Co-operative Group and future changes to tax legislation.

1.8 Valuation of Visa International preference shares and deferred consideration

The Committee considered the basis of valuation of Visa International preference shares and deferred consideration resulting from the sale of the shares in Visa Europe in 2016 and challenged the assumptions previously applied to determine whether these remain appropriate for the 31 December 2018 valuation.

1.9 Asset impairment

The Committee reviewed an analysis prepared by management outlining the impairment of assets, particularly relating to branch properties held for sale as at 31 December 2018, and concurred with the resulting year end carrying value.

1.10 Hedge accounting
The Committee reviewed the Group's hedge accounting programmes in depth over a number of Committee meetings including the accounting approach, together with an overview of the process and controls which operate over the programmes.

1.11 Unadjusted errors
The external auditors reported to the Committee the misstatements identified in the course of their work, including in respect of prior years; there were no unadjusted errors that were material individually, or in aggregate, to the financial statements.

1.12 Fair, balanced and understandable
The Committee considered whether the Annual Report and Accounts 2018 are fair, balanced and understandable. The Committee satisfied itself that there was a robust process of review and challenge to ensure balance and consistency. This process included internal verification of the document and senior level review of the document both on an individual and committee basis prior to a meeting of the Committee held to review and consider the Annual Report and Accounts in advance of approval by the Board.

The Committee has considered the following matter in relation to future reporting periods:

1.13 IFRS 16 – Leases
The Committee was regularly updated as to the implementation of IFRS 16, the impact of which is set out in note 1 to the financial statements. The Committee reviewed the implementation approach, and the progress made.

2. Governance over accounting policy and judgements

The Committee considered the governance to support financial reporting risk including the Accounting Policy Forum, which oversees accounting policy and the Key Judgements Forum which reviews and challenges significant accounting judgements, including the key sources of estimation uncertainty.

3. Performance Evaluation

3.1 External audit
The external auditor is appointed by shareholders to provide an opinion on the financial statements and certain other disclosures prepared by the Directors.

The Audit Committee is responsible for oversight of the external auditor, including reviewing the audit strategy and, on behalf of the Board, approving the audit fee. The Audit Committee has developed and implemented a policy on the supply of non-audit services by the external auditor to avoid any threat to auditor objectivity and independence, taking into consideration any relevant guidance on the matter.

Non-audit services are normally limited to assignments that are closely related to the annual audit or where the work is of such a nature that existing knowledge and understanding is necessary. Management regularly provides the Audit Committee with reports on audit, audit-related and non-audit expenditure, together with proposals of any significant non-audit related assignments.

Total auditor's remuneration for the year amounted to £2.9m (2017: £5.5m). Details of the auditor's remuneration can be found in note 4 to the consolidated financial statements. The Audit Committee is satisfied that the remuneration payable to the auditor is not material relative to the income of the external audit offices and firm as a whole, and did not impair the objectivity and independence of the external auditor.

The Audit Committee evaluated the performance since appointment, independence and objectivity of EY and also reviewed their effectiveness as external auditor, taking into account the following factors:

- the competence with which the external auditor handled the key accounting and audit judgements and communication of the same with management and the Audit Committee;
- the external auditor's compliance with relevant regulatory, ethical and professional guidance on the rotation of partners;
- the results of the FRC review of the 2016 audit and the EY responses to the FRC's findings;
- the external auditor's qualifications, expertise and resources and their own assessment of their internal quality procedures; and
- the stability that would be provided by continuing to use EY.

During 2018, the external auditor provided the Audit Committee with a management letter summarising its main observations and conclusions arising from the 2017 year-end audit, half year reviews and any recommendations for enhancements to reporting and controls. Mitigating actions were identified for implementation. Internal Audit have been monitoring and tracking the implementation of these actions, with regular reporting to the Audit Committee on progress made.

3.2 Internal controls

The Board is ultimately responsible for the system of internal controls and it discharges its duties in this area by ensuring management implements effective systems of risk identification, assessment and mitigation. These risk management systems are designed to manage, rather than eliminate, the risk of failure to achieve business objectives and cannot provide absolute assurance against material misstatement or loss.

Management is responsible for establishing and maintaining adequate internal controls over financial reporting, including the consolidation process. Internal controls over financial reporting are designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external reporting purposes. A strategic planning, budgeting and forecasting process is in place. Monthly financial information is reported to the Board and management. The Executive Committee (ExCo) reviews performance against budget and forecast on a monthly basis and senior financial managers regularly carry out an analysis of material variances. Responsibility for reviewing the effectiveness of the internal controls has been delegated to the Audit Committee by the Board.

The Audit Committee uses information drawn from the following to carry out this review:

- Internal Audit provides objective assurance – their annual work plan is developed in conjunction with management and approved by the Audit Committee focusing on key risks and key internal controls. In the light of Internal Audit's recommendations, management develops and implements corrective action plans, which are tracked to completion by Internal Audit, with the results reported to Executive Management and to the Audit Committee;
- the Risk Management Framework for reporting and escalation of control issues; and
- further objective assurance is provided by external specialists.

3.3 Internal audit

The Bank has an internal audit department comprising 19 in-house auditors supported by internal audit co-source arrangements with Deloitte LLP, PwC LLP, KPMG LLP, Grant Thornton UK LLP and Protiviti Limited. The co-source arrangements, which have been in place for a number of years, support the Bank's requirements for specialist skills or additional resources where it would be inefficient to resource internally. The internal audit team comprises staff with a mix of professional skills and qualifications, including qualified accountants and auditors with recent financial experience. Independence of the internal audit function is supported by the Internal Audit Director reporting directly to the Chairman of the Audit Committee and administratively to the CEO.

To provide coverage of risks, internal audit has an audit universe which provides a holistic view of audit coverage at a business entity and process level. This is supplemented by an assessment of inherent risks and control environment, aligned to the Risk Management Framework. The internal audit plan is aligned to the financial plan and also covers mandatory requirements from relevant regulators.

The internal audit plan is based upon a quarterly planning cycle which continues to give flexibility on the type of assurance provided and aligns to the developing risk profile. The internal audit plan is approved by the Audit Committee, and shared with the regulator.

During 2018, the scheduled internal audit reporting activity addressed a cross section of key operations and internal control mechanisms. A total of 41 internal audit reports were delivered for the 2018 Internal Audit plan (2017: 44), which enabled the Audit Committee to assess the control environment overall and make recommendations for areas of focus to the Risk Committee and to the Board.

The Audit Committee is responsible for evaluating the performance of the Internal Audit function on a regular basis to ensure that the function complies with the Chartered Institute of Internal Auditors (CIIA) International Standards. In doing so, it has identified appropriate criteria for defining the success of Internal Audit and, in-line with the CIIA International Standards, delivery of the audit plan is not the sole criterion for this evaluation.

The last independent External Quality Assessment (EQA) was conducted in 2016. There were no high priority issues raised, and all of the suggested areas for improvement have been actioned.

Internal audit reports are issued to Executive Management and a summary of reports issued are reported to the Audit Committee on a quarterly basis. High and medium-rated audit issues and the related management actions are tracked to completion by internal audit. Where audit issues are overdue, these are reported to Executive Management, the Enterprise Risk Oversight Committee (EROC) and the Audit Committee. All issues and related management actions are recorded on a bank-wide risk management application and database to facilitate tracking and reporting. Monthly reports are produced on action status updates, which are shared with the business, Executive Management and other Board Committees.

VALUES AND ETHICS COMMITTEE REPORT

I am proud to present the Committee report for 2018. Throughout the year, the work of the Committee has continued to ensure co-operative values and ethics remain at the heart of the Bank. Our commitment to values and ethics remains at the heart of our thinking as we remain the only UK high street bank with a customer-led Ethical Policy that underpins everything we do.

In October, we were extremely delighted to see the launch by UK Finance of the Financial Abuse Code of Conduct as a result of our joint campaign with Refuge to raise awareness of the issue of financial abuse. The campaign which launched at the end of 2015 included the UK's largest study to date in this area in order to understand the prevalence of financial abuse in intimate relationships in the UK. We campaigned for the banking industry to come together to ensure there is adequate and consistent support for the victims of financial abuse and are extremely proud to see our efforts turn in to real actions for the industry.

Supporting co-operatives and the co-operative sector remains key and in the first half of 2018, the Committee was pleased to agree the extension of our funding for The Hive, the programme of support for new and existing co-operatives run by Co-operatives UK, until the end of 2020. Since the start of the programme in March 2016, to the end of 2018, 642 groups have benefited from support worth over £300,000 and which has impacted approximately 25,000 people and I have been really pleased to see some of the examples of co-operatives who have received the support generating growth in their communities.

The Committee has continued to oversee the partnership with youth homelessness charity Centrepoint and has been extremely impressed with the fundraising generated by our customers and colleagues. Through donations related to our mortgage proposition, last year's current account switching incentive, colleague and customer fundraising we have raised over £1m for Centrepoint since the start of our partnership in April 2017, which has enabled Centrepoint to establish their helpline in Manchester, providing direct support for our local community. We are delighted that we will be continuing our support for Centrepoint to the end of 2019 as they continue to build on their provision in Manchester and provide specialist support for young people who are homeless or at risk of homelessness.

We are committed to our Manchester base and, in 2018 we have supported a number of events which have reinforced our links with, and support of, the local Manchester and North West, community. A key highlight of these events was our involvement in the Bee in the City initiative which attracted people back into the city of Manchester. Our chosen design was symbolic of the Co-operative movement through references to the Rochdale Society of Equitable Pioneers.

I was delighted that once again we participated in the Manchester Pride Event, as colleagues from across the business joined the parade, demonstrating our ongoing commitment to diversity and inclusion. We were also proud to be the community sponsor of the Manchester Diverse City Dinner, held in October 2018, which, as part of the Diversity Project, is championing a more inclusive culture within the savings and investment profession.

Our community support continued throughout the year as we sponsored an award at the Northern Soul awards, celebrating cultural and entrepreneurial excellence and sponsored and attended the Northern Power futures event, inspiring the delegates to develop a greater working life and career in the North.

The Committee will continue to oversee this focus into 2019, supporting charities and communities and demonstrating the co-operative values through our delivery of the Ethical Policy.

Robert Dench
Values and Ethics Committee Chair
27 February 2019

Purpose of the Values and Ethics (V&E) Committee
To recommend to the Board, for its approval and adoption, the values and ethical policies, and to advise the Board of conformity to such values and ethics in our operations and activities.

V&E Committee membership	Date of appointment	Date of resignation
Laura Carstensen	Appointed 27 May 2014	Resigned 31 December 2018
Dennis Holt	Appointed 26 September 2017	Resigned 14 March 2018
Glyn Smith	Appointed 26 September 2017	
Charles Bralver	Appointed 26 September 2017	Resigned 31 August 2018
Bob Dench (Chair)	Appointed 14 March 2018	
Christiaan Vogelzang	Appointed 1 September 2018	

The Values and Ethics Committee was constituted on 1 November 2013, demonstrating the Bank's commitment to promoting and conducting its business in accordance with its established values and ethics. The Chief Executive Officer regularly attends the Values and Ethics Committee.

Ever since we were initially established, our customers have expected the Bank to have clear values, and in 1992 we became the first bank to have a customer-led Ethical Policy. This policy has now been in place for 26 years and remains unique in UK banking because it is shaped by our customers and embodies the values of the co-operative movement. The Ethical Policy is published on the Bank's website at: www.co-operativebank.co.uk/aboutus/ourbusiness/ethicalpolicy

The Committee's Terms of Reference require it to meet twice during the year; however, the Committee met more frequently in 2018 than required by its Terms of Reference. This was particularly important as it focused on a review of performance against the five pillars of the Ethical Policy, namely: ethical banking, ethical products and services, ethical business, ethical workplace and culture and ethical campaigning. This is summarised in an annual review for approval by the Board. The Committee met four times during 2018 and has agreed to meet four times during 2019 to ensure that more substantive items are reviewed together.

The Chair of the Committee, together with each of the Chairs of the Remuneration and Risk Committees, engaged on a regular basis to ensure that there was consideration of values and ethics in the discussion and reporting of issues at Board and Committee meetings, including matters such as product reviews, policies and Executive remuneration structures.

The Committee Chair, together with other members of the Committee, will attend the Annual General Meeting to answer any shareholder questions on the Committee's activities.

Principal responsibilities and key areas of discussion of the Committee on behalf of the Bank

Principal responsibilities of the Values and Ethics Committee	Key areas discussed and reviewed by the Committee in 2018
Values and ethical policies	
• Recommend to the Board for approval and adoption the values and ethical policies. • Represent, monitor and advise the Board on matters concerning the interests of customers, suppliers, employees and other stakeholders in their dealings with the Bank in line with the Articles of Association having regard to the: (i) legal and regulatory requirements applicable; (ii) need to be commercially sustainable and profitable; and (iii) desirability of maintaining and enhancing image and public reputation.	• The Committee oversaw the continued adherence to the Bank's Ethical Policy - the latest version of which was launched in January 2015. • The Committee reviewed and approved the Bank's annual values and ethics Report which features the key steps taken to bring the Ethical Policy to life and embed ethics in to how we do business. The report can be found on the Values and Ethics page of the Bank's website. • Consideration of matters by the Board regularly draws upon the views and advice of the Committee in respect of the interests of stakeholders and values and ethics.
Monitoring and reporting values and ethics related activities and alignment to the Bank's Ethical Policy	
• Customer satisfaction levels (with a focus on service levels and on the product offering in the light of the values and ethics policies, in each case assessed by reference to relevant customer metrics). • Alignment of treatment of customers with our values and ethics. • Alignment of employee training and culture with values and ethical policies. • Corporate social responsibility, community investment, environmental and other projects and activities. • The approach to improving the social and environmental impacts of our own operations. • Establishment of a clear ethical policy and ethical strategy informed by customer consultation that aligns with the commercial strategy and is reviewed annually. • The extent to which Executive remuneration policies are consistent with the values and ethical policies. • Provision of products and services to sectors/organisations with a clear social justice purpose or community benefit. • The development of products and services with ethical features. • The choice of suppliers, partners and third party relationships which should be informed by the Bank's Ethical Policy. • Allocation of resource and budget to the V&E function. • Ethical campaigning activities and adherence to any commitments made under Pillar 5.	• The Committee monitored complaints resolution and the level of improvement in customer satisfaction and receives regular updates from the Customer Service and Customer Insight teams. • The Committee receives updates as required on the Vulnerable Customers work and reviews the work in relation to Vulnerable Customers at least annually. • The Committee was updated on the embedding of the values and ethics framework. • The Committee considered the allocation of 'Customers who Care' provision and considered the campaigning priorities which in 2017 resulted in the partnership with Centrepoint. The Committee also continued to support the colleague volunteering scheme and has been monitoring the uptake amongst colleagues which increased over 2018. • The Committee considered and evaluated the impact of a number of programmes on values and ethics. The Committee also supported the commitment to an ethical workplace including monitoring its commitment to the Living Wage, the Gender Pay Gap and the HM Treasury's Women in Finance Charter. • The Committee utilised the values and ethics scorecard to track performance against values and ethics related metrics. • The Committee confirmed that remuneration policies remained a matter for the Remuneration Committee, but that they would continue to consider the impact on values and ethics.
Statement to Co-operatives UK	
• Monitor compliance with the statement to Co-operatives UK; and report on this at least annually to the Board.	• Regular meetings continue between management and Co-operatives UK to monitor compliance with the statement. • The Committee monitored progress against the commitment to the three year partnership with Co-operatives UK – The Hive, a business support programme to promote social and economic development and enterprise in accordance with co-operative values.

During 2018, the Values and Ethics Committee of the Holding Company reviewed, monitored and challenged policies, transactions and reports in accordance with its Terms of Reference.

RISK COMMITTEE REPORT

The overall risk culture of the organisation has continued to build upon the progress of prior years. The Committee has continued to review and challenge the work undertaken to identify, mitigate and report risks through the Bank’s Risk Management Framework (RMF). The Committee has focused on ensuring asset growth is consistent with the low-risk, high-quality appetite the Board has set, whilst remaining vigilant to the residual risks of the resolution of historical issues during their close down phases, including the remediation of conduct breaches. Reporting and management information (including credit management information) considered by the Committee have continued to be improved, as have controls over financial crime (including anti-money laundering), the control framework relating to conduct and product risk and the management and governance of model risk. Going forward, the Committee will continue to monitor any risks which could affect the ability to implement the 2019–2023 Financial Plan.

Derek Weir
Risk Committee Chair
27 February 2019

Purpose of the Risk Committee

The purpose of the Risk Committee of the Bank is to review and challenge the Bank's risk appetite and report its conclusions to the Board for approval, and oversee the implementation of the Bank's RMF, taking a forward-looking perspective and anticipating changes in business conditions.

The purpose of the Risk Committee of the Board of the Holding Company is to review and challenge the Bank's risk appetite and RMF, and approve the Holding Company's risk appetite and risk policy which shall be aligned to the RMF.

Risk Committee membership	**Date of appointment**	**Date of resignation**
Derek Weir (Chair)	Appointed 30 September 2014 Chairman since 26 January 2016	
William Thomas	Appointed 1 January 2014	
Charles Bralver	Appointed 23 April 2015	Resigned 31 August 2018
Laura Carstensen	Appointed 1 July 2016	Resigned 31 December 2018
Glyn Smith	Appointed 10 October 2016	
Christiaan Vogelzang	Appointed 1 September 2018	
Paul Copley	Appointed 1 September 2018	

The Risk Committee met in total nine times during the financial year; six times for regularly scheduled meetings with three additional meetings to specifically consider the ICAAP, ILAAP and Recovery Plan. In performing its duties, the Committee has access to the services of the Chief Risk Officer, the Chief Executive Officer, the Chief Financial Officer, the Director of Internal Audit and the General Counsel, as well as external professional advisors. To support the alignment between the role of the Risk Committee and the Audit Committee, the Chair of the Audit Committee is a member of the Risk Committee and the Chair of the Risk Committee is a member of the Audit Committee. Derek Weir and William Thomas are also members of the Remuneration Committee. This provides the cross-over between the work of the Remuneration and Risk Committees and ensures that qualitative and quantitative advice is provided to the Remuneration Committee on risk weightings to be applied to performance objectives incorporated in setting levels of executive remuneration.

During 2018, the Risk Management Framework has been, and continues to be, refined to reflect the changing nature of the risks the Bank is exposed to. The Committee has worked closely with the Audit Committee to monitor risk management and internal controls.

Principal risks and the level of acceptable risks are determined by reference to what is stipulated in the risk appetite statements, aiming to ensure that there is an adequate system of risk management and that the levels of capital and liquidity held are consistent with the risk profile of the business. Exposure to credit and other risk types such as market, liquidity, operational, pension, reputational and other risks that are inherent in our industry such as strategy, product range and geographical coverage, and the processes for managing those risks, are described in detail on pages 70 to 102. The principal risks and uncertainties faced are described in the risk management section on pages 63 to 69.

Principal responsibilities and key areas of discussion of the Committee on behalf of the Bank

Principal responsibilities of the Risk Committee	Key areas discussed and reviewed by the Committee in 2018
Risk Management Framework (RMF)	
• Review and challenge the design, implementation and effectiveness of the RMF and make recommendations to the Board for approval. • At least annually, review and approve all new policies and those which have changed materially, supporting the RMF. • Ensure the remit of the risk management function has: - adequate resources and appropriate access to information to enable it to perform its function effectively and in accordance with the relevant professional standards; and -adequate independence, being free from management or other restrictions. • Review the capability to identify, assess, and manage new risk types.	• During 2018, the Committee actively discussed the embedding of the RMF and an update was provided to each meeting of the Committee. The Bank Risk Report includes a RMF Dashboard, Credit Asset Quality Dashboard, Compliance Dashboard and a Financial Crime Dashboard for the Committee to review and challenge at each business as usual meeting. • During 2018, the Committee reviewed and recommended the RMF Policy and Strategy to the Board for approval, and reviewed all new policies and those which had changed materially, supporting the RMF Policy. • During 2018, the Committee considered a report which reviewed the remit, independence and effectiveness of the Risk and Compliance functions.
Risk culture	
• Review, promote and challenge the risk culture, and seek assurance to satisfy itself that an appropriate risk culture prevails in the organisation. • Provide qualitative and quantitative advice to the Remuneration Committee on risk weightings to be applied to performance objectives incorporated in executive remuneration.	• At each meeting of the Committee, the Chief Risk Officer presents a Bank Risk Report which provides a holistic view of risks, including a summary of the key risk appetite trends, significant risks and emerging risks. Individual detailed risk appetite returns and credit risk metrics are also presented to the Risk Committee at each meeting. • The Committee reviewed the embedding of risk into performance objectives and role profiles as part of the project to embed the RMF, which resulted in all employees having at least one risk-related objective for 2017 and 2018. The Chief Risk Officer has reviewed risk weightings applying to executive remuneration structures and provided analysis to support Remuneration Committee activities in this area.
Risk appetite, limits and tolerances	
• Review, challenge and recommend to the Board for approval, all new risk appetite statements and at least annually, or more frequently as required, the risk appetite. • Review, challenge and approve any material changes to the risk appetite measures, tolerances and limits. • Review, challenge and exercise oversight of capital and liquidity management and advise the board on strategy for capital and liquidity management. • Annually review, challenge and recommend to the Board for approval the ICAAP. • Annually review, challenge and recommend to the Board for approval the ILAAP. • Review, challenge and recommend to the Board for approval, submissions to competent authorities to be submitted in the Board's name.	• During 2018, the Committee has continued to work with the Chief Risk Officer to refine the quality of data reporting seen at Committee and Board levels in order to assist the Committee in its oversight of the monitoring of risk appetite, of risk acceptances and of risk events. • The Committee reviewed, challenged and recommended to the Board for approval the risk appetite during 2018, and changes to market risk and liquidity risk appetite as part of the RMF. • The Committee reviewed and challenged the utilisation of delegated lending within the boundaries of the Lending Discretion Framework during 2018, and the Committee reviewed, challenged and recommended the ICAAP, ILAAP and Recovery Plan to the Board for approval. • A regular progress update was provided on model risk to each business as usual meeting of the Committee during 2018. • Prior to recommending to the Board for approval, the Committee reviewed all material submissions to be provided to regulatory bodies.
Business strategy	
• Provide detailed review and challenge of proposed business strategy giving consideration to the impact on the risk profile and make recommendations to the Board. • Ensure an appropriate due diligence is carried out focusing on risk aspects and implications for risk profile and appetite when advising the Board on strategic acquisitions or disposals.	• The Committee, throughout 2018, discussed and monitored the principal risks and uncertainties faced. • The Risk function reviewed the 2019-2023 Financial Plan and reported its findings to the Board in November 2018.
Risk monitoring	
• Consider, oversee and advise the Board on, and provide challenge on the Bank's exposure to, all principal risks to the business, and dedicate clear and explicit focus to current and forward-looking aspects of risk exposure, especially where those risks could undermine strategy, reputation or long term viability. • Review and challenge management's risk mitigation and control remediation actions. • In co-operation with the Audit Committee, monitor identified control failings and weaknesses that raise systemic risk issues and management actions taken to resolve them.	• The Committee monitors all principal risks to the business using the Bank Risk Report which provides a holistic view of risk, including significant and emerging risks and risk appetite trends. • During 2018, the Committee reviewed reports on potential breaches of risk appetite and proposed actions to resolve them. • The Committee considered key corporate exposures in terms of consolidated exposures and large exposure positions and risk mitigation. • The Committee has received regular reporting to help it review IT risk and the remediation programme.

Principal responsibilities of the Risk Committee	Key areas discussed and reviewed by the Committee in 2018
• Review reports on any material breaches of risk limits and the adequacy of proposed action. • Consider risks posed by the current and prospective macroeconomic and financial environment, drawing on financial stability assessments such as those published by the Bank of England, the Prudential Regulation Authority, the Financial Conduct Authority and other authoritative sources that may be relevant for the Bank's risk policies when preparing advice for the Board.	• The Committee has considered reporting of emerging risks during the year together with regulatory feedback given to the Bank by the • Prudential Regulation Authority and the Financial Conduct Authority and the plans agreed with regulators published to the market from time to time.
Regulatory risks and compliance	
• Review and approve the annual Risk Assurance plan and the reasons for any significant changes to the plan, taking into account the regulatory risks identified from time to time. • Review, consider and challenge regular reports from the Director of Compliance and Financial Crime and keep under review the adequacy and effectiveness of the regulatory risk and compliance function. • Receive prompt notification of any material adverse reports or sanctions by any competent authority.	• The Committee has challenged the development of certain risk models to support the attestation of, and achieving compliance with, the Capital Requirements Regulation. • The Committee reviewed, challenged and approved the 2018 Compliance & Financial Crime Assurance Plan. • The Chief Risk Officer and Director of Compliance and Financial Crime attended Risk Committee meetings during the year providing regular reporting analysis. • During 2018, the Committee considered a report which reviewed the remit, independence and effectiveness of the Risk and Compliance functions.
Bribery prevention, anti-money laundering/terrorist financing and Code of Conduct	
• Review and challenge the adequacy and effectiveness of the systems and procedures for the prevention of bribery and annually review and approve the Bank's Anti-Bribery and Corruption Control Standard. • Review and challenge regular reports from the Money Laundering Reporting Officer and the adequacy and effectiveness of the anti-money laundering and counter terrorist financing systems and controls. • Review and recommend to the Board for approval the Code of Conduct and the Personal Investment Dealing Policy.	• The Committee reviewed and approved the Bank's Anti-Bribery and Corruption Control Standard in February 2018. • The Committee considered reporting from the Money Laundering Reporting Officer during the year, including the Annual Money Laundering Reporting Officer's Report. • The Committee reviewed and recommended the Code of Conduct and Personal Investment Dealing Policy to the Board during the year.
Risk reporting	
• Receive reports, findings and recommendations from the Enterprise Risk Oversight Committee noting significant issues. • In co-operation with the Audit Committee, review and approve the statements to be included in the Annual Report and Accounts concerning internal controls and risk management.	• Through the reporting from the Chief Risk Officer, the Committee continued to have access to the findings and recommendations of the Enterprise Risk Oversight Committee on matters referred to the Risk Committee or to the Board. • The Committee continues to work closely with the Audit Committee in determining the Company's annual reporting.
Chief Risk Officer	
• Recommend to the Board the appointment and/or removal of the Chief Risk Officer. • Meet at least once a year with the Chief Risk Officer without the presence of management.	• The Committee Chair regularly met with the Chief Risk Officer without the presence of management during the year. • Private sessions were held regularly between the Committee and the Chief Risk Officer. • In December 2018, the members of the Risk Committee recommended to the Board that it accepted Steven Pickering standing down as Chief Risk Officer and the appointment of Richard Lees as his replacement, subject to regulatory approval, which was received on 21 December 2018.

During 2018, the Risk Committee of the Holding Company approved, reviewed, monitored and challenged policies, transactions and reports in accordance with its Terms of Reference.

NOMINATION COMMITTEE REPORT

During 2018 there were significant changes in the composition of the Board and the Executive Committee, and the Nomination Committee was instrumental in the review and recommendation of the implementation of these changes. Following his appointment in July 2018, the Chief Executive Officer has reviewed, and continues to review, the structure and key responsibilities of the Executive Committee to ensure that the customer is placed at the heart of everything the Bank does and to ensure it offers a competitive, ethical point of difference through its products and services. The Committee also continued its focus on Board effectiveness, with The Effective Board LLP having been engaged to conduct an external evaluation, while succession planning remained a key constituent of the Committee's work to ensure that the Board and the business have the skills, knowledge and experience as they seek to deliver against the Bank's strategic aims to be a Digital Ethical Bank.

Robert Dench
Nomination Committee Chair
27 February 2019

Purpose of the Nomination Committee
To lead the process for Board and Senior Executive appointments by comprehensively reviewing and making recommendations on the Board and Executive Committee composition, succession planning for Executive Directors, Non-Executive Directors and certain Senior Executives, identifying and nominating candidates for Board vacancies and evaluation of candidates for the Board.

Nomination Committee membership	Date of appointment	Date of resignation
Dennis Holt (Chair)	Appointed 25 February 2014	Resigned 14 March 2018
Bob Dench	Appointed 14 March 2018	
Aidan Birkett	Appointed 27 October 2015	Resigned 14 March 2018
William Thomas	Appointed 26 September 2017	
Charles Bralver	Appointed 26 September 2017	Resigned 31 August 2018
Derek Weir	Appointed 14 March 2018	
Paul Copley	Appointed 1 September 2018	

During 2018 the Nomination Committee met seven times and focused on new appointments and the overall strengthening of the Board to meet the needs of the business and to be responsive to the regulatory environment in which we operate.

Full regard to the benefits of diversity in all its elements, including gender diversity is given. The Executive Committee approved the enforcement of 50:50 male: female short lists with the Bank's recruitment agencies in November 2018. The Board considers diversity, of which gender diversity is one element, to be an important part of the search mandates for new appointments to the Board.

As the Board structure develops and further appointments are considered, the Bank will continue to encourage the executive search consultancies engaged in the search process to reflect diversity in the lists of candidates nominated for the consideration of the Board. Active searches for additional Directors are currently under way.

During 2018 the number of women on the Bank's Board remained at one. In 2016, the Board set a target to have a minimum of three women on the Board, which still remains.

Principal responsibilities and key areas of discussion of the Committee on behalf of the Bank

Principal responsibilities of the Nomination Committee	Key areas discussed and reviewed by the Committee in 2018
• Regular review of the structure, size and composition of the Board. • Identify and nominate, for approval by the Board, candidates to fill Board vacancies having regard to the balance of skills, knowledge, independence, experience and diversity on the Board. • Review the leadership needs, both executive and non-executive, and consider proposals in respect of these. • To review the independence, effectiveness and commitment of each of the Non-Executive Directors. • Formulate succession plans for Directors and Non-Executive Directors, Senior Executives and Senior Management Function role holders including the reappointment of any Non-Executive Director at the conclusion of their specified term of office taking into account the skills and expertise needed on the Board in the future and the continued ability of the organisation to compete effectively in the marketplace. • Annually review the diversity policy, including gender, and the measure of objectives set in implementing the policy, and progress on achieving the objectives. • Make recommendation to the Board on membership of the Audit, Remuneration and Risk Committees, and any other Board Committees. • Review the results of the Board performance evaluation including the time required from Non-Executive Directors. • The election or re-election of Directors by shareholders at the AGM.	• Review of the structure, size and composition of the Board along with the skills, knowledge and experience of its members to ensure that Directors remain able and have sufficient time to discharge their duties and responsibilities effectively and to the high standard required. • During 2018 the Committee considered a number of nominations at both Board and Senior Executive level. Following the resignation of Liam Coleman as Chief Executive Officer, Andrew Bester was appointed as Chief Executive Officer on 9 July 2018. Tom Wood also stood down as Chief Financial Officer on 9 October 2018 and Nick Slape was appointed as Interim Chief Financial Officer on 1 October 2018 and his appointment as Chief Financial Officer was confirmed on 13 December 2018 following his receipt of regulatory approval on 3 December 2018. • The B shareholders of the Holding Company are entitled to appoint up to two Directors to the Board of the Holding Company, and the Holding Company is entitled to appoint up to two Directors to the Board of the Bank Company, who are designated as B Directors of the Holding Company and the Bank Company. The B shareholders engaged external recruiters and identified and interviewed, along with members of the Committee and the Human Resources Director, Paul Copley and Christiaan Vogelzang. The Nomination Committee reviewed the candidate reports in April 2018 and recommended their appointment as B Directors. • Richard Lees received regulatory approval to act as Chief Risk Officer on 21 December 2018 and Steven Pickering stood down on 11 January 2019 following a handover period. • Succession planning, including identification of external and potential external candidates for senior vacancies which may arise on a crisis; short; medium or long term basis. • The Board adopted the Board Diversity Policy recommended by the Committee in February 2015. The Committee has since reviewed and monitored progress against the Policy and has committed to considering an updated Policy during 2019. • During the year and as a result of new appointments to the Board and members stepping down during the year, the Committee considered and made recommendations to the Board on committee composition across all Board Committees. • The Committee reviewed the position of Directors offering themselves for election and re-election at the 2018 AGM. • The Committee commissioned an external Board evaluation by The Effective Board LLP to be commenced in late 2018, with the results due to be presented in the first quarter of 2019.

During 2018, the Nomination Committee of the Holding Company reviewed monitored and challenged policies, transactions and reports in accordance with its Terms of Reference.

BOARD EFFECTIVENESS

Performance evaluation

Effective relationships between the Executive Directors and the Non-Executive Directors are critical to the operation of the Boards. The Board agendas will continue to balance the need to provide oversight and governance across the business and to provide challenge where appropriate.

In November 2018, the Group engaged The Effective Board LLP to carry out an external review of the effectiveness of the Board and Board Committees of the Bank Company. The review was conducted using criteria set by the PRA which covered three areas: how the SMCR functions are fulfilled; how Risk is identified and escalated; and if the governance structure is sufficient for its purposes. The Effective Board LLP undertook the following work for the purposes of the review:

- review of documentation;
- interviews with members of the Board and key members of the Executive team;
- observation of the Board, Risk, Audit, Remuneration, Nomination and Values and Ethics Committee meetings; and
- consideration of peer and best practices in order to bring insight and analysis.

The Board and Committee Effectiveness Reports were presented by The Effective Board LLP to the Boards on 6 February 2019. The Effective Board LLP observed a number of strengths, in particular, the commitment of the Board and the Executive team during a period of change and challenging activity. The review identified a number of areas for improvement and an action plan is being devised, supported by The Effective Board LLP, which will be presented to the Nomination Committees and to the Boards in order to address these areas.

Induction and continuing professional development

All newly appointed Directors undertake a structured induction programme which is designed to provide them with key business information about the Group, and includes briefing sessions with members of the Executive team and a branch visit where possible.

As part of the process, an individual training needs profile is designed for each Director, which is reviewed periodically. Throughout 2018, the Board continued to hold collective training sessions which took place around the dates of Board meetings. In addition to formal training sessions, the Directors, where appropriate, have one-to-one sessions with members of the Executive. An electronic 'Reading Room' is available as a resource to enable all Directors to access, revisit and review copies of presentations and materials from formal development sessions.

The Chairman's role is to address the development needs of the Boards as a whole, with a view to developing their effectiveness. He ensures that the Directors' professional development needs are identified and that they are adequately informed about the Group and their responsibilities as Directors.

Senior Managers and Certification Regime (SMCR)

The Bank continues to deliver robust compliance with its governance over the Senior Managers and Certification Regime as set out in the Director's report on page 27. Directors have been briefed extensively and received further training on 30 October 2018 in connection with the requirements set out in the SMCR.

Conflicts of interest

Pursuant to the Companies Act 2006, the Directors have a duty to avoid situations in which they have or may have interests that conflict with those of the Bank, and Holding Company unless that interest is first authorised by the other Directors. The Bank and the Holding Company's Articles of Association allow the Boards to authorise such potential conflicts and there is a procedure to deal with actual or potential conflicts. Directors are reminded, at each Board meeting, of their duty to report actual or potential conflict as soon as they become aware of any such events. All potential conflicts approved by the Boards are recorded in the Conflicts of Interest Register which is reviewed at each Board meeting to satisfy itself that all potential conflicts are appropriately considered and have been approved. The Boards have determined that a Director with a potential or actual conflict will not be permitted to form part of the quorum or vote upon the matter giving rise to the conflict. The Boards have put in place protocols to address potential conflicts arising from the appointment of the Non-Executive Directors who are not independent for the purposes of the Companies Act 2006. Prior to taking up any external appointment or responsibilities, Directors are asked to consult with the Company Secretary and the Chairman of the Board.

Directors and their interests

No Director had a material interest at any time during the year in any contract of significance, other than a service contract, with the Holding Company, Bank Company or any of its subsidiary undertakings. No Director had a beneficial interest in any shares in the Holding Company, or Bank Company.

Insurance and indemnities

During 2018, the Holding Company maintained appropriate Directors' and Officers' liability insurance on behalf of all Group entities in respect of legal action against their Directors and Officers. Various Officers had, and continue to have, the benefit of indemnities from the Bank Company in relation to losses and liabilities they may incur in their employment. In addition, qualifying third party indemnity provisions (as defined by section 234 of the Companies Act 2006) were in operation during 2018 and are in force for the benefit of the Directors in relation to certain losses and liabilities which they may incur in connection with their appointment.

Professional advice and Board support

A number of external consultants provide professional advice to the Boards from time to time. There is a procedure in place by which, with prior agreement, the Directors may take independent professional advice at the Group's expense in furtherance of their duties.

STATUTORY DISCLOSURES INFORMATION

Share capital structure, transfer restrictions and takeover bid related disclosures

The Bank's total issued share capital of ordinary shares of £0.05 each are all owned by the Holding Company. The Holding Company's share capital is divided into Class A ordinary shares of £0.0001 each and Class B redeemable preference shares of £0.01 each. For further information relating to ownership, please see the Corporate Governance Report on page 24.

Transfer of shares

The shareholder of the Bank Company may transfer any shares in any manner which is permitted by law and is from time to time approved by the Board of the Bank Company. The A ordinary shares in the Holding Company are freely transferrable save that they may not be transferred to a commercial competitor without the sanction of a special resolution of the Holding Company. Restrictions on the transfer of the B redeemable preference shares can be found within the Holding Company's Articles of Association and further details are shown in the Corporate Governance Report on page 24.

PRA approval is required if a person intends to acquire or increase its 'control' of a UK authorised person (which includes the Bank). Acquiring 'control' includes where a person first holds 10% or more of the shares or voting power in the Bank directly or indirectly via the Holding Company. Increasing control means when an existing shareholder increases their shareholding or entitlement to voting power from a holding below certain thresholds to a holding above them. The thresholds are 10%, 20%, 30% or 50% of shares or voting power.

Voting rights

Subject to the Bank's Articles of Association and to any special rights or restrictions as to voting for the time being attached to any shares, the provisions of the Companies Act 2006 shall apply in relation to voting rights of the Bank's shares.

Ordinary shareholders are entitled to vote at general meetings and appoint proxies. On a show of hands, every member or proxy has one vote. On a poll, every member present in person or by proxy has one vote for every share held. Ordinary shareholders may receive: (1) dividends; (2) assets upon the liquidation of the Bank; and (3) capital payments through the capitalisation of reserves as provided in the Bank's Articles of Association.

Subject to the provisions in the Holding Company's Articles of Association, no A ordinary shareholder shall be entitled to receive notice of, nor attend or vote at a general meeting of the Holding Company, save for resolutions being proposed in respect of:

- abrogating or varying any respective rights or privileges attaching to the A ordinary shares;
- for the winding up or dissolution of the Holding Company;
- in respect of the purchase or redemption (save for the redemption of the B shares in accordance with the Articles of Association) of any share capital of the Holding Company; or
- In respect of a Bank Exit or IPO Exit.

B redeemable preference shareholders are entitled to receive notice, attend and vote at a general meeting of the Holding Company in accordance with the Holding Company's Articles of Association.

Where shareholders of the Holding Company are entitled to vote at a general meeting on a show of hands every holder or proxy shall have one vote and on a poll, shall have one vote in respect of each respective share registered in the name of the holder.

DIRECTORS' REPORT ON REMUNERATION TO THE SHAREHOLDER

Note that all employees are employed by the Bank and governed by the Bank's Remuneration Committee

Dear Shareholder,

I am pleased to present our Directors' report on remuneration for 2018 for the Group and the Bank. Our full Directors' remuneration policy, which was re-approved at the 2016 AGM, remained unchanged in 2018 and can be found on:
https://www.co-operativebank.co.uk/assets/pdf/investorrelations/annual-report.pdf

Looking back on 2018

A summary of matters considered by the Remuneration Committee in 2018 is set out in pages 53 to 54.

Following the Bank's Restructuring and Recapitalisation in 2017 and return to compliance under CRD IV legislation, restrictions constraining the ability to award variable pay no longer applied in 2018. The Committee, therefore, gave consideration to the options for the re-introduction of variable pay in 2018 and beyond. This has included reviewing options for long term incentive awards to selected key staff going forward, as we aim to ensure our reward framework continues to align our executives with shareholder expectations, as well as the customer experience.

The Committee specifically approved a new management incentive scheme for 2018, under which Executive Directors and a select number of the senior management team were granted a one-off award of Restricted Stock Units (RSUs). More detail on this 'Management Incentive Plan' (MIP) is provided on page 55.

The Committee has continued to consult with the Value and Ethics Committee on aspects of remuneration policy and specifically variable pay.

Ensuring strong performance of our key Executives is critical to achieving a sustainable and profitable bank. During 2018, therefore, the Committee continued its close monitoring of progress against plan and individual performance. Allied to this focus on performance, the risk policies and reporting processes remained central to the Committee's agenda and continue to be strengthened.

The Chief Risk Officer's quarterly reports continued to provide a regular structured review of material events discussed by the Risk Adjustment and Individual Risk Adjustment Committees. Malus and clawback policies continue in force, and are taken into account by the Bank's Individual Risk Adjustment Committee when considering the effects of major risk events before referral to the Remuneration Committee to consider any action required.

The Committee has also overseen further work undertaken during the year to strengthen the process for the Bank's remuneration reporting to the regulators and supported the development of a Material Risk Taker (MRT) identification policy, principles and process map, which was provided to the regulators, as part of the 2018 Remuneration Policy Statement (RPS) submission.

Executive Directors and the Committee, once again, considered it was important to recognise the contribution of the wider workforce for 2018. We made an annual allowance payment for colleagues below senior levels (equivalent to 3% of base pay subject to satisfactory performance ratings being achieved).

Targeted adjustments to individual base salaries were also applied where appropriate to recognise high performance and ongoing criticality to the business. In addition, we also awarded a number of retention awards to colleagues who were identified as key to the delivery of the restructuring plan.

During the second half of 2018, the Bank appointed a new CEO and there were a number of further subsequent Board and executive changes. The Committee approved the remuneration for the new CEO, together with that of other new Board and Executive Committee members.

Aidan Birkett stepped down from the Board in March 2018, Charles Bralver stepped down from the Board in August 2018 and Laura Carstensen stepped down from the Board in December 2018. We thank them for their contribution as members of the Remuneration Committee.

Remuneration Committee agenda for 2019

The Committee will oversee the re-introduction of variable pay arrangements, including annual bonuses for all employees and long term incentive awards to selected staff, in 2019. Awards will vary subject to both corporate and individual performance in accordance with regulatory requirements and will remain within the parameters set out in the approved policy. We will remain committed to ensuring our reward framework continues to align our executives with shareholder expectations, as well as the customer experience. The Committee will continue to consult with both the Risk Committee the Value and Ethics Committee on certain aspects of remuneration policy.

It is pleasing to note, that through the Bank's focused work on gender diversity, in particular for internal promotions, we are on track to meet our Women in Finance target of 40% of senior management roles occupied by women in 2020. The Committee will continue to monitor progress towards this target, which will address our Gender Pay Gap, the result of fewer women than men in senior management positions. We will also monitor market practice following the UK Government's publication of the Companies (Miscellaneous Reporting) Regulations 2018, with particular regard to future requirement for larger quoted companies to publish CEO pay ratios in its annual reporting of Directors' remuneration.

On behalf of the Committee, I would like to thank you for your continued support.

William Thomas
Remuneration Committee Chair
27 February 2019

Purpose of the Remuneration Committee
The Remuneration Committee has the delegated responsibility to determine remuneration for the Executive Directors and the Executive Committee of the Bank and Directors of the Holding Company. It sets, and recommends to the Board for approval, the overarching principles and parameters of the Remuneration policy across the Bank and applies the necessary oversight to ensure an overall coherent approach to remuneration is implemented for all employees.

During 2018, the members of the Remuneration Committee were as follows:

Committee membership	Date of appointment	Date of resignation	Attendance
William Thomas (Chair)	Appointed 26 September 2017 Chair from 19 December 2017		6
Laura Carstensen	Appointed 30 May 2014	Resigned 31 December 2018	4
Aidan Birkett	Appointed 1 July 2016, Interim Chair from 26 September 2017 to 19 December 2017	Resigned 14 March 2018	2
Derek Weir	Appointed 26 September 2017		6
Charles Bralver	Appointed 26 September 2017	Resigned 31 August 2018	3
Paul Copley	Appointed 1 September 2018		1

In 2018, the Committee's business agenda required six meetings to allow consideration of the Bank's ongoing reward strategy, including options for the re-introduction of variable pay arrangements, together with succession changes for both the Board and the Executive Committee, in addition to regular business items.

The Committee continues to regularly consult with the Chief Executive Officer (CEO), Human Resources Director (HRD), General Counsel and Chief Risk Officer (CRO), all of whom may attend meetings of the Committee but are not present when their own remuneration or terms and conditions are being considered. The Head of Reward also provides advice on compensation and benefits to the Committee. The General Counsel and Company Secretary advises the Committee on corporate governance.

The Committee also works closely with Chairs of the Risk Committee, Audit Committee, Nomination Committee and Values and Ethics Committee.

Advisor to the Committee
The Committee received support and advice from external advisors during the year. The table below provides details of the external advisors to the Committee and the fees paid to them in 2018. Fees are charged based on the scope and requirements of the work, as agreed with the Committee or the Bank as a whole. Deloitte LLP is a member of the Remuneration Consultants Group and, as such, voluntarily operates under the code of conduct in relation to 'executive remuneration consulting in the UK'.

The total fee paid in 2018 to remuneration advisors for remuneration-related advice to the Committee was:

Name	2018 Fees £000s	2017 Fees £000s
Deloitte LLP[1]	**43**	37

1. The figure above captures only the fees for services in respect of advice that materially assisted the Remuneration Committee.

The Committee last reviewed the provision of advice in 2015 and with regard to the position of the Bank considered it appropriate to retain Deloitte as advisor during 2018.

Principal responsibilities and key areas of discussion of the Committee on behalf of the Bank

Principal responsibilities of the Remuneration Committee	Key areas discussed and reviewed by the Committee in 2018
Remuneration policy	
• Policy and contractual terms including salary, benefits and pension: • Set and recommend to the Board for approval, the overarching principles and parameters of the remuneration policy to ensure an overall coherent approach to remuneration in respect of all employees. Ensure that all relevant legislation, regulatory requirements and guidance on remuneration practice are considered and complied with when setting the remuneration policy; • Support the Chairman of the Committee in overseeing the development and implementation of the Bank's remuneration policy and supporting practices; • The remuneration policy should have regard to the risk appetite of the Bank, whilst being consistent with effective risk management principles, be aligned to the long term strategic goals, and comply with relevant applicable legislation; and • Review at least annually the ongoing appropriateness and relevance of the remuneration policy and exercise its judgement in the application of the remuneration framework and policies to promote the long term success.	• The Committee reviewed the Bank's remuneration policies, with regard to the easing of CRD IV restrictions and the possible re-introduction of variable pay; and • The Committee considered the approach to remuneration going forward, in light of the lifting of these restrictions for 2018 onwards.
Material Risk Takers	
• Review and agree the Remuneration policy and decisions relating to remuneration, including variable pay, performance related payments and pension arrangements, for any employees, present and prospective, in senior management roles, risk takers and staff in control functions that are included on the Bank's register of Material Risk Takers and therefore subject to the Remuneration Code; and • Seek advice from the Board's Risk Committee, the Chief Risk Officer (by way of quarterly reports from the Chief Risk Officer) and consider the impact of Income Recognition and Asset Classification and provisioning (IRAC) on the risks arising from the remuneration policies for the purpose of the ICAAP within the key areas discussed and reviewed by the Committee and other regulatory matters and specific risk adjustments to be applied to performance objectives of any Material Risk Takers, set in the context of incentive packages.	• The Committee continued to oversee work being undertaken to strengthen the process for Remuneration Policy Statement (RPS) reporting to the regulators and supported the development of a MRT identification policy, principles and process map, which was provided to the regulators, as part of the 2018 Remuneration Policy Statement (RPS) submission • The Committee approved the list of designated Material Risk Takers in 2018; and • The Committee received the report on gap analysis work carried out by PwC. The work bench-marked the Bank's Remuneration Policy Statement and associated processes against regulations, with a view also to ensuring that these were suitably robust to support the anticipated re-introduction of variable pay.
Executive Directors and the Executive Committee (the Executive) Having regard to the overarching principles and parameters of the Bank's remuneration policy: **Policy and contractual terms:** • Establish, implement and maintain the policy on all aspects of the remuneration of the Executive present and prospective, including pension rights and any compensation payments; • Review at least annually the on-going appropriateness and relevance of the Remuneration policy; • Oversee contractual arrangements and approve the principal terms and conditions of employment; • Ensure that contractual terms on termination, and any payments made, are fair to the individual, and the Bank, that failure is not rewarded and that the duty to mitigate loss is fully recognised; • Within the terms of the agreed policy and in consultation with the Chair and/or Chief Executive, as appropriate, determine the total individual remuneration package of each Executive and the Chair, ensuring full compliance with the relevant legislation and regulatory requirements; • Ensure that the remuneration of each Executive (including any payments for loss of office) is consistent with the most recently approved Remuneration policy; • Review salaries, normally at the start of the financial year, which may include reference to comparisons against the agreed financial services sector market policies; and • Advise on any major changes in employee benefit structures throughout the Bank or its subsidiaries which relate to Executives.	• Remuneration for the new Chief Executive Officer was approved, together with that of other new Executive Committee members. All remuneration arrangements for Executive Committee members satisfy regulatory requirements, whilst ensuring performance priorities, risk and reward are all aligned with strategic objectives. • Arrangements were approved for the departing Chief Executive Officer and Chief Financial and Restructuring Officer, all of which were in line with Policy and contractual terms.

Principal responsibilities of the Remuneration Committee	Key areas discussed and reviewed by the Committee in 2018
Incentive arrangements – annual and long term	
• Determine and review the policy for all incentive plans for approval by the Board and shareholders in accordance with the agreed Remuneration policy; • Approve any amendments to all incentive plans prior to obtaining any necessary shareholder approval; • For any such plans, determine each year whether awards will be made, and if so, the overall amount of such awards, the individual awards to be made and set appropriate performance targets. Ensuring that appropriate consideration has been taken for risk matters and events that have occurred both in year and in prior years; • Authorise payments under incentive plans, subject to the achievement of performance and balanced scorecard metrics, and underpin as applicable, and in accordance with the rules of the plan; • Authorise the application of the malus and clawback policy in relation to specific individual adjustments that may be agreed through the risk adjustment review process; • The Committee shall determine the design, performance measures and associated targets for any performance related pay schemes operated by the Bank in respect of Executives and Material Risk Takers and review individuals' performance against those targets and agree any payments proposed; and • The Committee shall consider not less than annually whether or not it is necessary to apply malus and/or clawback in relation to the performance related pay schemes.	• Notwithstanding earlier decisions taken, with regard to historical incentive plans, the Committee continued to closely monitor progress against plan and individual performance; In addition, the Committee considered, but ultimately decided not to recommend, that the Bank or Holding Company proceed with a new Annual Incentive Plan(AIP) for 2018; • The Committee, however, did continue to consider proposals for the re-introduction of annual bonus and long term incentive arrangements going forward and in this regard was also consulted with regard to a review of Bank-wide and functional scorecards; • The Committee recommended, for Board approval, the establishment of a 2018 Management Incentive Plan for certain Executives; • The Committee approved a Restructuring Retention Plan for senior employees considered critical to delivery of the Bank's restructuring; and • Quarterly reports continued from the Chief Risk Officer, together with recommendations from the Individual Risk Adjustment Committee, to regularly consider material events and whether or not malus and/or clawback should be applied to previous variable pay awards, in relation to these events.

During 2018, the Remuneration Committee of the Holding Company reviewed monitored and challenged policies, transactions and reports in accordance with its Terms of Reference.

Remuneration policy and practices

The Bank's remuneration structures are designed to align with its values and ethics and aims to promote the long term sustainable success of the business.

Fixed remuneration, which includes salary for all employees and role-based allowances for Executives and certain other senior roles, is set having regard to individual roles, scope of responsibilities and experience, together with internal and external benchmarks.

Variable pay, which includes annual and long term incentive plans, aims at rewarding individual and collective performance achieved in a manner consistent with the Bank's values and ethics and within the Bank's risk appetite.

A range of employee benefits, including core, voluntary and flexible benefits, and a defined contribution pension scheme are also provided.

In setting remuneration policies the Remuneration Committee seeks to:

- link reward to business and individual performance, ensuring that performance metrics are balanced so as not to encourage undue/inappropriate risk;
- ensure that the remuneration of senior management can be justified clearly by reference to independently sourced market data on comparable organisations, and is set in a manner broadly consistent with the systems used to determine pay for employees elsewhere in the Bank, taking into account quantum, market comparators, affordability;
- determine the specific conditions for variable annual and longer term pay so that these are financially prudent, directly aligned to approved strategic plans and thus support and drive long term sustainability; and
- establish measures which explicitly reward the ongoing support for co-operative values and ethics.

Policy for variable annual and long term remuneration incorporates the use of a Balanced Scorecard which is directly aligned to the Bank's strategic Plan. This scorecard includes non-financial measures to ensure that there is no encouragement of inappropriate risk taking (compliance with the Risk Management Framework) and awards may not be made if underlying capital conditions are not met. Variable remuneration awarded to employees whose roles have a material impact on the Bank's risk profile meets with CRD IV requirements. This includes appropriate deferral of awards and risk adjustment through malus and clawback provisions.

The Bank, thereby, takes into account current and future risks in its remuneration processes and how this approached is described in more detail on pages 57 and 58.

In order to ensure full scrutiny and separation of interests, the proposers of any such actions are (i) Chairman, in respect of Executive Directors, (ii) CEO for Executive Committee members, and (iii) HR Director for all other colleagues.

Variable pay features
The Bank's policy includes a discretionary annual bonus plan, the Annual Incentive Plan (AIP).

AIP awards are determined by reference to the performance against a scorecard of combined financial, strategic, cultural and risk performance metrics, which are reviewed annually by the Remuneration Committee.

Although, following its Restructuring and Recapitalisation in 2017, the Bank's variable pay policy is no longer constrained, under the requirements of CRD IV regulations no AIP awards were made in respect of the 2018 financial year.

A new one-off Management Incentive Plan' (MIP) was implemented in late 2018, under which the Executive Director and a select number of the senior management team were granted an award of Restricted Stock Units (RSUs). Under the terms of this 'Management Incentive Plan' (MIP), participants' interests are aligned with those of other Holding Company shareholders, as they will generally only be able to exercise their RSU option at the same time as existing shareholders are able to realise value from their equity. This particular wording to be agreed. Key principles and features of the MIP are as follows:

- There has been a one-off grant under the MIP in 2018, which forms one element of the Bank's transition towards a "business as usual" reward framework over the coming years, and the rebalancing of fixed and variable remuneration.
- The MIP awards entitle participants to acquire a number of A ordinary shares of £0.0001 in the Holding Company, equal in value to a proportion of the increase in the Group's value above specified hurdles.
- Participants will generally only be able to exercise their RSU at the same time as existing shareholders are able to realise value from their equity. In line with regulatory requirements, awards under the MIP have been granted by reference to a performance assessment of the prior year.
- No financial performance conditions will attach to the RSU options beyond the equity value hurdle; however, to comply with regulatory requirements, a proportion of any award will be at risk subject to an assessment of non-financial performance criteria including risk regulations and control, feedback from the regulators and review of customer outcomes. An individual performance assessment will also apply through which the Remuneration Committee will have the ability to reduce the maximum amount that might vest.
- Malus and clawback provisions will also apply in line with regulatory requirements.

Senior Colleagues (Executive Committee and certain Material Risk Takers) also have access to grants under a Long-Term Incentive Plan (LTIP), as provided under our approved policy. Notwithstanding the Bank's Restructuring and Recapitalisation during 2017 and with that the easing of constraints under the requirements of CRD IV regulations, the Remuneration Committee considered but again decided not to grant any awards in 2018, under LTIP. Moreover, having regard to the 2014/15 LTIP, the Remuneration Committee decided that, given the underlying performance of the Bank over the performance period of the plan, no awards would vest.

Under the rules of the LTIP, performance will be tested at the end of the plan, including an assessment of compliance with CRD IV requirements, at which point, if applicable, variable payments will be made:

- Assessment of performance for the LTIPs will take into consideration achievement against the specified metrics to determine a maximum payment. Risk matters throughout the plan period will be considered by the Remuneration Committee, to determine if adjustments should be made before an overall achievement is agreed.
- Malus and clawback policies apply to all such plans.
- If the Bank is not capital compliant at the time of performance being assessed, regardless of the achievement against the plan metrics, no award will be made.

The only LTIP still operating during 2018, therefore, was the plan implemented in 2016, the performance conditions of which are described below:

Performance measures	**Weighting**	**Threshold**	**On-target**	**Maximum vesting**
Operating cost:income ratio	25%	25% of award vests for operating cost:income ratio of 67.6%	60% of award vests for operating cost:income ratio of 60.8%	100% of award vests for operating cost:income ratio of 55.3%
Absolute Total Shareholder Return (TSR) per share	25%	25% of award vests for absolute TSR per share of 8% per annum.	60% of award vests for absolute TSR per share of 12% per annum.	100% of award vests for absolute TSR per share of 20% per annum.
Total Bank Profitability	20%	25% of award vests for 'Profit before Tax' of £86.3m	60% of award vests for 'Profit before Tax' of £95.9m	100% of award vests for Profit before Tax' of £105.4m
Total Financial measures	**70%**			
Risk and control	10%	Performance against strategic measures will be assessed by the Remuneration Committee using individual scorecard ratings ranging from 1 – 10, with 50% of the award vesting at the threshold rating of 5. The detailed targets within each measure are not disclosed as these are deemed to be commercially sensitive. Retrospective disclosure will be provided in the 2019 Directors' Remuneration report, subject to commercial sensitivity no longer remaining.		
People	10%			
Customer	10%			

At the point of re-capitalisation in 2017, this plan was 21 months through the 36 months performance period. As a result, the Remuneration Committee decided that the most appropriate action was to crystallise the awards at their value immediately prior to the re-capitalisation. It is the intention for these crystallised awards to be paid out in line with original timelines of the plan and according to the deferral requirements in place at that time. They also remain subject to malus and clawback.

Control function remuneration
Remuneration for Control Functions is not determined within the business unit alone, in order to avoid conflicts of interest. The split between fixed and variable pay is reviewed annually by the Remuneration Committee, to ensure it continues to reflect best practice. The level of any pay increases or variable pay awards is directly linked to individual performance ratings. Such ratings are determined against objectives specific to Control Function roles, which do not relate or impact to the business areas they control. When attracting staff to fill a vacant Control Function role, external market data, internal relativity and remuneration policy are used to determine an appropriate remuneration package.

Ratio between fixed and variable pay
The Bank applies the Material Risk Taker variable remuneration cap. Variable remuneration for Material Risk Takers cannot, therefore, exceed twice the amount of their fixed remuneration. Shareholder approval, for the maximum '2 x fixed remuneration' ratio was received in May 2014, the voting at which is shown in the table below:

Resolution	Votes for	% of votes cast	Votes against	% of votes cast	Total votes validly cast	Votes as % off issued ordinary share capital[1]	Votes withheld
14 [2]To authorise the Bank to apply a ratio of the fixed to variable components of total remuneration for 'Remuneration Code Staff' that exceeds1:1, provided that the ratio does not exceed 1:2	202,502,426	99.55%	919,591	0.45%	203,422,017	81.37%	-

1. 250,000,000 ordinary shares, being the Bank's issued voting share capital as at 6.00pm on 28 May 2014, the time by which shareholders who wanted to attend and vote at the AGM must have been entered on the Bank's register.
2. Resolution 14 was a special resolution.

The application of the variable remuneration cap is reflected in the full Director's remuneration policy.

Guaranteed variable pay, buy outs and retention payments
In line with the Remuneration Code, the Bank does not award guaranteed variable remuneration, except where necessary in the first year of employment to reflect loss or forfeit of previous employer awards, and provided the Bank has a strong capital base. The Bank may also make buy-out awards on recruitment to replace forfeited deferred awards that will vest no faster than the awards they replace.

Retention bonuses are only used, in exceptional circumstances. During 2018, the Committee approved a Restructuring Retention Plan. Retention awards were also made, during the year, to colleagues critical to the successful delivery of key projects in operational areas such as PPI and Mortgage operations.

All guaranteed variable, buy-out and retention awards are made in line with the applicable regulatory requirements.

Any payments on termination of employment will be in accordance with the provisions of CRD IV. In line with regulatory requirements, any payments in relation to early termination will reflect performance achieved over time and will not reward failure or misconduct. Any payments made to Material Risk Takers on termination of employment will be considered as to whether they should be subject to the variable pay cap and/or relevant pay-out process rules.

Typically, termination payments will consist of basic salary and other contractual benefits for the notice period.

Both parties, the Bank and the Executive Directors, must provide a notice period of 12 months in length. In normal circumstances, Executive Directors will be required to work their notice period. In the event Executive Directors are not required to fulfil their notice period, they will receive a payment in lieu of notice, or they may be placed on garden leave. Other Material Risk Takers have notice periods varying between 6 and 12 months, depending on the role undertaken.

Statutory redundancy payments may also be made, when appropriate. In accordance with European Banking Authority (EBA) guidelines, such statutory payments are not taken into account for the purpose of calculating the ratio between variable and fixed remuneration.

Comparison of Executive Director remuneration policy with the wider employee population
The Bank has one Remuneration policy that is communicated and applied throughout the organisation. Our policy has been designed to support recruitment, motivation and retention and to encourage the highest standards of performance within the Bank's risk appetite. The policy is specifically aligned to the Bank's Values and Ethics policy and a report is provided to the Values and Ethics Committee each year.

The principles set out in the Remuneration policy inform decisions for all employees, including Executive Directors. The Remuneration Committee takes into account pay levels and benefit arrangements throughout the Bank to ensure the arrangements provided to Executive Directors are appropriate.

Remuneration packages may vary to take account of role-specific factors in different areas and are determined by reference to market levels, skills requirements and internal relativities:

- annual incentive plan (when applicable) – corporate performance measures are consistent for Executive Directors and other employees; the level of bonus opportunity differs by role to reflect levels of accountability and contribution to results. Bonus awards payable to employees classified as Material Risk Takers for regulatory purposes are subject to deferral and part-payment in shares/share-linked instruments in accordance with regulatory requirements; and
- long-term incentive plan – a limited number of Senior Executives may be invited to participate in the long-term incentive plan, having regard to accountability for delivery of the Plan and strategy. The terms of the long-term incentive plan apply equally to all participants, including Executive Directors.

The Remuneration Committee receives and considers internal and external information as appropriate to guide decisions on remuneration including, but not limited to, the results of employee satisfaction surveys and feedback sought from internal stakeholders (such as the CRO and Values and Ethics Committee) and external stakeholders.

Pillar 3 disclosures on Material Risk Takers
The Remuneration Committee is required to oversee remuneration for staff identified as Material Risk Takers.

Under the implementation of the European Capital Requirement Directive (CRD IV), new rules on remuneration were introduced with effect from 1 January 2014, and the definition of Material Risk Takers was revised. As part of these changes, the EBA published Regulatory Technical Standards containing qualitative and quantitative criteria to identify staff considered as Material Risk Takers, due to their professional activities having a material impact on the institution's risk profile.

In 2018, eighty two Material Risk Takers were identified within the Bank according to these criteria. This is higher than the previous year (sixty three), following further re-organisation and a review of senior roles and responsibilities within the new organisational structures. The list of Material Risk Takers was approved by the Remuneration Committee. Material Risk Takers are subject to the PRA Remuneration Code provisions which are applied in their remuneration arrangements and include:

- the deferral of at least 40-60% of their variable remuneration over a period of at least three years;
- the delivery of at least 50% of their variable remuneration in the form of shares or share-linked instruments; and
- risk adjustment of any variable remuneration award, including: malus/clawback on annual incentive plan, deferred bonus plan and long-term incentive plan awards. For any award made on or after 1 January 2015, clawback may apply for up to seven years following award.

Determination of variable annual and long term remuneration incorporates the use of a balanced scorecard which is directly aligned to the Bank's strategic plan. This scorecard includes non-financial measures to ensure that there is no encouragement of inappropriate risk taking (compliance with the Risk Management Framework) and awards may not be made if underlying capital conditions are not met.

Within the scorecard, there are five performance categories, including 'Risk and Control', with appropriate weighting applied to performance measures against specified targets. For 'Risk & Control' these measures include:

- net operational losses as a % of net income;
- timely reporting of risk issues;
- timeliness of actions to address identified risk issues;
- effective Anti-Money Laundering (AML) controls;
- credit impairment charge aligned with strategic plan;
- timeliness and effectiveness of actions to address Internal Audit findings;
- satisfactory relationships with the Bank's Regulators; and
- meeting the requirements of upcoming regulatory and industry changes.

The Chief Risk Officer's (CRO) quarterly report to the Remuneration Committee provides a summary of year-to-date risk performance, including:

- an overview of risk KPIs used to monitor risk, including key metrics, tolerances, outcomes for the year to date and any trends or significant movements, covering all the Bank's principal risks identified through the Risk Management Framework;
- a commentary on the strength of the risk governance and control environment, together with the cultural attitude to risk within the Bank;
- an outlook on emerging issues that are likely to present new risks to the Bank over the next year, areas requiring further enhancement and any planned changes to be made during the next performance year;
- a discussion of any risk events/issues identified; and
- a commentary on other, difficult to quantify risks, such as significant regulatory correspondence and cultural or behavioural issues.

Accordingly, annual bonus pools will be risk adjusted:

- according to performance against Bank scorecard measures;
- having regard to decisions/actions in relation to risk appetite and potential future impact;
- risk events which have already happened and reported through to the Remuneration Committee via the Bank's Risk Adjustment Committee; and
- at the discretion of the Remuneration Committee, having regard to the Bank's overall performance and the experience of shareholders and customer.

Individual adjustments to variable pay may then be made, having regard to material risk events that have been reported to the Bank's Individual Risk Adjustment Committee (IRAC), which looks at individual impact and accountability for such issues.

1. Aggregate remuneration – all employees

	2018		
Remuneration	**Fixed £m**	**Variable £m**	**Total £m**
	108.6	0.1	108.7

Total number of Directors, Material Risk Takers and employees as at 31 December 2018 was 3,361.

2. Aggregate remuneration – Senior Management and other Material Risk Takers by business area

	2018				
	Number of employees	**Remuneration type**	**Retail & Business Banking (£m)**	**Corporate functions (£m)**	**Internal control functions (£m)**
Senior management[1]	28	Fixed	0.51	9.8	1.22
		Variable	0.01	0.03	0.00
Other MRTs	55	Fixed	1.25	5.14	2.00
		Variable	0.00	0.00	0.04
Total	**83**		**1.77**	**14.97**	**3.26**

1. Senior management consists of those in a Senior Management Function (SMF) role under the Senior Managers Regime plus any other Non-Executive Directors, Executive Directors or, Executive Committee members.
2. CEO and Non-Executive Directors included in Corporate Functions.
3. Aggregate Remuneration is the amount of remuneration paid during the year i.e. pro-rated for joiners and leavers, and includes pension contributions.
4. There were no AIP awards, no deferred bonus awards and also no LTIP awards made in 2018.

3. Aggregate deferred remuneration – Material Risk Takers by business area (£)

		2018				
Business Function	**MRT status**	**Outstanding unvested (value as at 31 December 2018)[1]**	**Outstanding vested during financial year (value as at 31 December 2018)**	**Amount awarded in 2018 (value as at award)**	**Amount paid out in 2018 (value as at 31 December 2018)[2]**	**Reduced from prior years through performance adjustments (value as at 31 December 2018)**
Retail & Business Banking	Senior management	40,383	28,167	145,000	28,167	-
	Other MRTs	6,169	3,560	269,583	3,560	-
Corporate functions	Senior management	193,984	115,762	170,833	115,762	-
	Other MRTs	19,750	5,301	474,607	5,301	-
Internal control functions	Senior management	14,205	6,575	115,000	6,575	-
	Other MRTs	45,599	33,846	137,583	33,846	-
	Total	**320,090**	**193,211**	**1,312,301**	**193,211**	**-**

1. The total deferred amount for both Senior Management and Others includes awards from the 2014 Transitional Deferral Awards Plan (TDAP), 2014, 2015 AIPs and LTIPs and 2016 LTIPs, together with retention and bonus buy-out awards also subject to deferred payment schedules.
2. Represents the value of previously deferred 2014 AIP awards vesting in 2018.

4. Aggregate remuneration – sign-on and retention payments

		2018			
		Sign-on awards (value at award)		**Retention awards (value at award)**	
Business Function	**MRT status**	**Number of employees**	**Amount awarded in 2018 (£ value as at award)[1,2]**	**Number of employees**	**Amount awarded in 2018 (£ value as at award)**
Retail & Business Banking	Senior management	-	-	1	145,000
	Other MRTs	-	-	4	269,583
Corporate functions	Senior management	-	-	3	170,833
	Other MRTs	-	-	9	474,607
Internal control functions	Senior management	-	-	1	115,000
	Other MRTs	-	-	2	137,583
	Total	**-**	**-**	**20**	**1,312,606**

1. No sign-on or buy-out payments were made in 2018.
2. No guaranteed awards were made in 2018.

5. Aggregate remuneration – severance payments

		2018				
Business Function	**MRT status**	**Number of identified employees**	**Amount awarded in 2018 (£ value as at award)**	**Amount paid out in 2018 (£ value as at 31 December 2018)**	**Amount deferred in 2018 (£ value as at 31 December 2018)**	**Highest award to a single employee (£)**
Retail & Business Banking	Senior management	-	-	-	-	-
	Other MRTs	-	-	-	-	-
Corporate functions	Senior management	3	-	1,823,972	-	1,125,000
	Other MRTs	5	-	705,619	-	200,000
Internal control functions	Senior management	-	-	-	-	-
	Other MRTs	-	-	-	-	-
	Total	**8**		**2,529,,591**	**-**	**1,125,000**

1. Severance payments on termination of employment are considered as to whether they should be subject to the variable pay cap and/or relevant pay-out process rules.
2. Severance payments awarded in 2018 were all deemed to be fixed remuneration.

6. Aggregate remuneration – high earners by band

Number of staff with total remuneration of EUR 1 million or more in 2018, by band[1]	**Number of identified employees[2]**
€1m – €1.5m	2
€1.5m – €2m	-
€2m – €2.5m	-
€2.5m – €3m	1
€3m – €3.5m	-
Above €3.5m	-

1. In accordance with Article 450 of the Regulation under CRD IV, the reporting of aggregate remuneration - high earners by band is prepared in Euros; using the rates published by the European Commission for Financial Programming and Budget for 31 December 2018 (1 GBP is equal to 1.1219Euro).
2. Of the three employees disclosed in the table above only one remains employed with the Bank as at the date of signing of the accounts.

Risk Management

61	Risk Management objectives and policies
70	Capital Risk
70	Credit Risk
94	Market Risk
100	Liquidity and funding risk

1. RISK MANAGEMENT OBJECTIVES AND POLICIES

1.1 Overview

The Board oversees and approves the Bank's Risk Management Framework (RMF) and is supported by the Risk Committee of the Bank. The Risk Committee's purpose is to review the Bank's risk appetite and report its conclusions to the Board for approval, oversee the implementation of the RMF, taking a forward-looking perspective and anticipating changes in business conditions. The purpose of the Risk Committee of the Board of the Holding Company, is to review and challenge the Bank's risk appetite and RMF, and approve the Holding Company's risk appetite and risk policy which shall be aligned to the RMF.

There is a formal structure for identifying, reporting, monitoring and managing risks. This comprises, at its highest level, risk appetite statements which are set and approved by the Board and are supported by granular risk appetite measures across the principal risk categories. This is underpinned by an RMF which sets out the high level policy, standards, roles, responsibilities, governance and oversight for the management of all principal risks.

Material risks and issues, whether realised or emerging, inclusive of those documented in relation to the RMF itself are described within section 1.6.

1.2 Approach to risk management

Responsibility for risk management resides at all levels within the Bank and is supported by Board and management level committees. A three lines of defence model is deployed on the following basis:

- 1st line – the business teams are the Risk Owners (ROs) and sit within the 1st line of defence. ROs are responsible for owning and managing all risks within defined appetites, ensuring supporting procedures are written, and are responsible for reporting the performance, losses, near misses and status of risks through governance;

- 2nd line – the Risk and Compliance functions act as the 2nd Line of defence. The Risk Framework Owners (RFOs) sit within the 2nd Line with the exception of some specialist areas where the RFO sits within 1st Line (for example Legal and Financial Reporting), the 2nd line Risk Function will provide oversight over the RFO activities in such cases; and

- 3rd line – the Internal Audit function assesses the adequacy and effectiveness of the control environment and independently challenges the overall management of the RMF.

1.3 Risk management strategy and appetite

The Board has primary responsibility for identifying the key business risks faced, approving the Risk Management Strategy through the setting of risk appetite, which defines the type and amount of risk the firm is prepared to take both qualitatively and quantitatively in pursuit of its strategic objectives. In addition, the Board approves key documents including the Internal Liquidity Adequacy Assessment Process (ILAAP) and the Internal Capital Adequacy Assessment Process (ICAAP).

Risk appetite is translated into specific risk measures which are tracked, monitored and reported to the appropriate Risk Committees (refer to section 1.5). The risk appetite framework has been designed to create clear links to the strategic planning process whereby appropriate metrics and limits for each risk category are established, calibrated and reported.

1.4 Principal risk categories

The RMF sets out the principles which define the risk taxonomy, identifies processes, ownership, responsibilities and the risk oversight required to support effective implementation of risk management. The constituent parts which cover the risk taxonomy are shown below:

Principal risk	Definition	Further constituent parts / Risk Taxonomy
Capital Risk	The risk that regulatory capital is inadequate to cover capital requirements.	
Credit Risk	The risk to earnings and capital arising from a customer's failure to meet their legal and contractual obligations.	• Credit risk Treasury • Credit risk Retail • Credit risk Corporate
Model Risk	The potential for adverse consequences caused by models. Model risk can lead to financial loss, regulatory penalty or fine, poor business or strategic decision making, incorrect financial reporting, damage to reputation or adverse customer outcomes.	
Market Risk	The risk of loss as a result of the value of financial assets or liabilities (including off-balance sheet instruments) being adversely affected by the movement in market prices, interest rates or exchange rates.	
Pension Risk	The risk to capital and funds from exposure to defined benefit scheme liabilities (to the extent that liabilities are not covered by scheme assets) and risks inherent in the valuation of scheme liabilities.	
Strategic Risk	The risk to the delivery of the Financial Plan.	
Operational Risk	The risk of loss resulting from inadequate or failed internal processes, people and systems or external events.	• Regulatory Risk • Conduct Risk • Product Risk • Fraud Risk • AML Risk • Financial Reporting Risk • Information & Data Risk • Payments Risk • Legal Risk • Technology Risk • Change Risk • People Risk • Third Party Supplier Risk • Physical Assets Risk (including health & safety) • Insurance Risk • Business Continuity Risk
Liquidity and Funding Risk	The risk that obligations cannot be met as they fall due or can only be met at excessive cost.	
Reputational Risk	The risk of damage to reputation, brand or image as perceived by internal or external stakeholders as a result of conduct, performance, or the impact of operational failures or other external issues.	

Note – in Q4 2018 the principal risks within the RMF were strategically revised and re-aligned to the size and complexity of the organisation; as a result four principal risks have been reflected as a constituent part of an alternative principal risk – Strategic (covered within capital), physical assets, insurance and business continuity (covered within operational). These changes will become effective in 2019.

1.5 Governance

The Board is the key governance body and is responsible for strategy, performance, and ensuring appropriate and effective risk management. It has delegated the responsibility for the day-to-day running of the business to the CEO. The CEO has established the Executive Committee to assist in the management of the business and deliver against the approved strategic plan in an effective and controlled manner.

The Board has established board committees and senior management committees to oversee the RMF, including identifying the key risks faced and assessing the effectiveness of any risk management actions. At the end of 2018, the formal committees in operation which oversee the effective management and oversight of the RMF are detailed in the table below:

Committee	Reports to:	Risk focus
Board		The Board has collective responsibility for the long term success of the Group and the Bank. Its role is to provide leadership of the firm within a framework of prudent and effective controls which enable risk to be assessed and managed. It sets the values and standards and ensures the obligations to its shareholders, customers and other stakeholders are understood and met. The Board sets the strategy and approves plans presented by management for the achievement of the strategic objectives it has set. It determines the nature and extent of the significant risks it is willing to take in achieving its strategic objectives and is responsible for ensuring maintenance of sound risk management and internal control systems.
Risk Committee (RC)	Board	In conjunction with the Audit Committee, the purpose of the Risk Committee is to review and challenge the risk appetite and RMF, and approve the risk appetite and risk policy which shall be aligned to the RMF.
Executive Committee (ExCo)	CEO	ExCo is responsible for defining and successfully implementing the Board approved strategy by monitoring and managing delivery against plan and applying appropriate risk management actions to emerging risks.
Bank Restructuring Committee (BResCo)	ExCo	BResCo is responsible for developing and monitoring the implementation of the restructuring and transformation / investment agenda.
Asset and Liability Committee (ALCo)	ExCo	ALCo is primarily responsible for overseeing the management of capital, market, earnings, liquidity and funding risks. Its responsibilities include identifying, managing and controlling the balance sheet risks in executing its chosen business strategy, ensuring the capital and liquidity position is managed in line with policy and that adequate capital is maintained at all times.
Enterprise Risk Oversight Committee (EROC)	ExCo	EROC provides a mechanism to ensure all risks are reviewed, challenged and approved in line with decisions made at the ExCo (with escalation to RC where required). EROC achieves some of its objectives through delegating responsibility to sub-committees, Conduct & Regulatory Risk, Operational Risk, Pension Risk and Credit Risk Oversight Committees. EROC will escalate where appropriate to the Board via RC.
Operating Committee (OpCo)	ExCo	OpCo is responsible for providing oversight and challenge across the Bank's operations, technology and customer service.
Product & Pricing Committee (PPC)	ExCo	PPC is responsible for the consideration of the Bank's brand, product, customer and channel strategies including new product launches or significant changes to existing products or supporting processes, annual product and tariff reviews, pricing decisions and return on equity analysis for front and back book plus legacy products
Trading Committee (TC)	PPC	TC provides oversight of the Bank's performance against the objectives of the strategic plan, review and approve proposed pricing changes and support the Bank's management of its liquidity position.
Model Risk Oversight Committee (MROC)	EROC	MROC ensures, on an ongoing basis, the model rating systems and material models are operating effectively. This includes providing Executive level review and challenge of the model risk and the impact on the business strategy. This is achieved through, but is not limited to, providing approvals relating to high materiality models and other approvals, such as any Temporary Model Adjustments (TMAs), which are independent of model materiality.
Credit Risk Oversight Committee (CROC)	EROC	CROC is responsible for monitoring significant credit risks and issues with the entire credit life cycle, the controls and management actions being taken to mitigate them and to hold to account the Executives responsible for actions. CROC reviews the credit risk strategy on an ongoing basis making recommendations to EROC as appropriate.
Operational, Compliance & Financial Crime Risk Oversight Committee (OCROC)	EROC	OCROC is responsible for monitoring significant operational risks and issues including significant conduct, regulatory, product, reputational, fraud and AML risks and issues, the controls and management actions being taken to mitigate them and to hold to account the Executives responsible for actions. OCROC oversees the current and emerging operational risk profile ensuring key risk exposures are managed within risk appetite, and reported to EROC, as appropriate including the monitoring of adherence to the RMF including a process for continuous improvement.
Pension Risk Oversight Committee (PROC)	EROC	PROC oversees all aspects of pension arrangements in which the Group or Bank is active in or sponsors, to ensure cost, risk, capital, investment and employee requirements are met.

1.6 Principal risks and uncertainties

The Principal risks and uncertainties detailed below primarily arise in relation to, and if material would impact the Bank as the Group's principal operating entity. However if any material risks materialise they would also impact the Group. Any specific Holding Company risks will be reported in subsequent years where applicable.

Where relevant, the Group as a whole applies the same principal risk categories and risk management processes to Holding Company, Bank Company and their subsidiaries.

This section is comprised of three parts:

- background - provides the context in which the principal risks and uncertainties should be understood;
- regulatory Deficiencies - summarises the deficiencies against regulatory requirements and expectations which constitute principal risks and uncertainties; and
- other key risks - outlines other key financial and non-financial risks and uncertainties as identified by the RMF and how they are being managed or mitigated. These are linked to the RMF risk taxonomy: see further 'Risk Management – section 1.4 Principal risk categories'.

1.6.1 Background

During 2018, the Bank maintained regulatory capital (CET1). However, the business, operating results, financial condition and prospects and/or ability to implement the strategy could be adversely impacted by, including, but not limited to:

- future changes to regulatory capital requirements (for example MREL) driven by regulatory stress testing results; and
- a failure to successfully implement or a delay in implementing the Plan and the consequent impact on the ability to comply with regulatory capital requirements which could lead to stress on TCR (Technical Compliance Record) compliance.

Risks relating to the key assumptions in the Financial Plan (2019-2023) (the Plan)

The successful execution of the Plan requires the simultaneous execution of a number of business assumptions including an increasing income profile, implementing cost reduction initiatives, management of capital resources and loss-absorbing capacity and the other risks and uncertainties faced.

The key assumptions underlying the Plan include:

Macroeconomic environment

Risks relating to the macroeconomic environment in which the Bank operates. In March 2017, the UK Government triggered the official process for withdrawing from the European Union under Article 50 of the Treaty of the European Union. It seems likely the Treaty will cease to apply to the UK from 29 March 2019 (unless an extension period is granted). The Bank manages these uncertainties by creating a range of base, upside and downside economic scenarios. Each of these scenarios is given a probability weighting, and the impact of each outcome is modelled. On a quarterly basis, each scenario is reviewed and approved. The outputs are used to generate the expected credit losses (ECLs) as part of the IFRS 9 modelling. The worst downside is representative of the impact the Bank might expect from a hard Brexit; therefore a specific economic scenario for Brexit is not required.

Net interest margin (NIM)

The Plan targets a widening of, and steady increase in, NIM over the medium-term. The Plan targets are most susceptible to interest rate changes and competitive pressures. “Lower for longer” interest rates (including the Bank of England base rate), will restrict the Bank’s ability to increase NIM and, consequently, restrict organic capital generation and profitability, as well as any improvement in the Bank’s operating cost:income ratio.

There is a risk that base rates may not increase as soon, or as much as, the Bank has assumed, or may even reduce. There is a risk that competitive pressures, and the need to maintain market share to maintain viable market volumes, could reduce the Bank’s market share or that regulatory pressures constrain the anticipated growth in the Bank’s business volumes. All of the above could have an impact on the future income projections.

The Plan assumes asset pricing increases due to both internal and external factors. The external factors are assumed to be increases seen in the market generally, whereas the internal factors are changes being made internally which could result in the widening of asset pricing. If, and to the extent that, these increases are not forthcoming as assumed in the Plan, the Bank’s actual NIM trajectory could be significantly lower than targeted. The Bank may be unable to preserve its market share or the assumed margins in relation to new business mortgage assets or other products through the life of the Plan.

The Plan assumes that the Bank’s market share in new business mortgage assets is preserved, allowing it to increase prime residential mortgage asset volumes, particularly in Platform over the life of the Plan, and for unsecured loan and credit card balances to decrease. The UK personal financial services industry is mature and as a result growth for the Bank often requires taking market share from competitors. There is a risk the Bank loses market share to other banks, building societies, insurance company competitors and new “fin-tech” entrants, which may impact the Bank’s plans to increase profitability based on preserving its market share of new mortgage origination and other products over the life of the Plan. The Plan also assumes mortgage margin improvements are driven by the Bank entering new markets or products or increasing the Bank’s market share of certain types of products or services.

The Plan assumes the Bank will be able to improve its margin on variable rate savings products as the Bank of England base rate rises due to its assumed interest rate pass-back strategy. There is a risk that, if market forces determine the timing and proportion of interest rates to be passed back to its customers is not feasible, the Bank may not be able to widen its net interest margin to the extent it has projected or at all. The Plan also assumes the mix of deposits on the balance sheet increases on both variable savings and SME deposits, which are typically superior margin products for the Bank. If the growth in variable deposits does not increase to the levels assumed in the Plan, it is likely more expensive sources of funding will be required, which would impact on future income projections. The deposit strategy is supported by the release of new products which help to diversify the funding strategy. There is a risk if these products are not launched, deposit expense will be higher than planned, and/or that the benefits assumed from these new products will not deliver as expected given this would be the first time a new deposit account has been launched for a number of years.

The Plan assumes the cost of attracting liquidity will reduce over its life primarily as a function of the pass-back assumptions to liability customers as the Bank of England base rate increases. If the liquidity profile cannot be supported based on the assumed pass-back assumptions, this will result in an increase in the cost of liquidity, which will have an adverse impact on NIM.

The ability to achieve the NIM targets assumes market share is preserved over the life of the Plan. Competition is faced in all the core markets and there is a risk market share is lost to competitors and NIM and new mortgage business origination targets are not met. The heavy reliance on mortgage revenues to drive income may increase susceptibility to competitive risks.

The behaviour of mortgage customers at the end of their offer rate periods is an important assumption in deriving the forecast net interest income and net interest margin within the Plan. Particularly important is the proportion of customers that revert to a reversionary product and the length of time they remain on this product. These behaviours are largely driven by factors outside of the Bank's control and therefore the risk exists where the observed behaviour in future is different to what is anticipated in the Plan.

A failure to grow net interest margin as planned could have a significant material adverse effect on overall financial condition, operating results and prospects.

Growing mortgage assets
The Plan targets growing the Bank's net core customer assets in each year of the Plan, primarily driven by the Bank's Platform business. The Bank's ability to achieve these targets depends on improvements in its customer proposition, the success of a limited number of intermediaries who also sell mortgages of the Bank's competitors, and the Bank's ability to attract business in a crowded, competitive, and mature UK mortgage market. There is a risk the growth of these assets will be significantly less than planned, and mortgage retention and/or new mortgage origination may be significantly less than expected due to any number of internal or external factors. These factors include, for example, a possible contraction of the UK mortgage market, and/or the risk of the Bank being unable to support the underwriting process by improving its existing predictive credit modelling capability, and/or the risk that the Bank's relationships with one or more intermediaries may deteriorate for a variety of reasons, including competitive factors, and/or that the pressure to achieve the targeted increases may create new conduct, legal and regulatory risks. There is also a risk the Bank will not be adequately resourced or will not have sufficient expertise to deal with increased business volumes as a result of cost reduction initiatives, or an inability to retain and/or attract employees necessary for the implementation of the Bank's strategy.

Tier 2 / MREL
A core component of the Bank's strategy and the Plan is further capital issuances with £400m MREL eligible debt planned in 2019. In addition, the Plan assumes the Bank will complete further MREL qualifying debt issuances so as to meet its ongoing MREL requirements. There are risks that the Bank will be unable to raise the required capital and MREL qualifying debt on acceptable terms, when planned or at all, and the Bank will be unable to meet its MREL and PRA buffer when planned, or at all. The Bank's Plan targets a surplus to the Bank's PRA Buffer by the end of the Plan. To the extent the Bank does not perform in line with its strategy, and the Plan or regulatory requirements are increased for any reason, additional CET1 or other capital may be required over and above that assumed in the Plan. Any failure to raise such further capital could have a material adverse effect on the Bank's regulatory capital position, including its ability to maintain adequate loss-absorbing capacity. A failure by the Bank to meet some of its regulatory capital and loss-absorbing capacity requirement will impact the actions that management is able to take to implement the Plan and may lead to the Authorities exercising some or all of their powers over the Bank, including, among other things, powers of intervention, the power to mandatorily write-down the Bank's and Group's capital instruments and the power to place the Bank within the Special Resolution Regime if it is considered the Bank would otherwise be likely to fail.

Transformation and Restructuring Activity/Delivery
The Plan assumes the ability, capability and capacity to deliver transformation/restructuring, remediation and change programmes and the cost reduction initiatives already underway without material deviation from planned timescales and costs. Historically, the Bank has had significant cost and delivery overruns when implementing complex large-scale change projects while not delivering the assumed planned benefits. Any deficiencies in appropriate governance and related programme management processes to assist with the satisfactory delivery of these activities could have an adverse effect on operating results and financial condition compared with those targeted in the Plan.

There are risks that the Bank may be unable to complete its transformation programmes when planned, that there may be a requirement to upgrade the Bank's systems, infrastructure, processes and controls, and that the programmes as a whole may cost significantly more than targeted or have a reduced scope for the same targeted costs, or deliver less benefit than planned, thereby impacting associated cost reductions or income-generation plans assumed in the Plan.

Cost reduction
The Bank's high operating cost:income ratio in 2018, inhibits the Bank's profitability and may hinder its ability to generate new capital and may be commercially unsustainable. This planned reduction is driven by both a reduction in the cost base and an increase in revenue. These operating cost reduction targets assume the Bank successfully implements cost reduction initiatives and operating expenditure and operating project costs are lower than in recent years. Such initiatives are largely focused on third party contracts, reduction in major sites and enhanced system productivity benefits.

There is a risk if the Bank does not deliver its cost reduction initiatives and/or does not grow its net interest margin in line with its targets, its costs relative to income will not decrease, which will continue to negatively impact its profitability and capital position. Furthermore, the implementation of cost reduction initiatives, for example reductions in full time equivalent ("FTE") numbers, changes to third-party supplier arrangements, and simplification of the Bank's product offering and distribution, may not achieve the targeted cost savings.

Instead, the Bank may be impeded from preserving its market share and be exposed to competitive pressure from competitors investing in their product offerings and/or expose the Bank to additional or new conduct and legal risks. This may limit the Bank's ability to deliver growth in its core customer asset base and mortgage asset volumes as assumed in the Plan.

Risk Weighted Assets (RWAs)
RWAs may be significantly greater than targeted, due to unforeseen worsening economic conditions (for example. higher unemployment and lower property prices) and any material increases in RWAs will significantly increase our capital requirements beyond those planned for.

Return to profitability
The successful development and implementation of the Bank's strategy requires difficult, subjective and complex judgements, including a range of factors which are not within the Bank's control, for example forecasts of economic conditions. Furthermore, the successful implementation of the Bank's strategy is contingent upon a range of factors which are beyond the Bank's control, including market conditions, the general business environment, regulation (including currently unexpected regulatory change), the activities of its competitors and consumers and the legal and political environment.

The targeted return to profitability relies on the ability to successfully mitigate the risks outlined above, particularly the ability to widen net interest margin and develop interest income, deliver the anticipated cost reduction and resulting operating cost:income ratio. If any of the risks above do materialise, this may result in lower future returns and lower than targeted profits.

The ability to deliver the Plan is heavily influenced by external factors which may mean the internal assumptions underpinning the Plan may be incorrect and negatively impact performance. This may include an impact on profitability, RWA's and capital ratios. Many of these are similar to those faced by other financial institutions, for example:

- lower interest rates remaining lower for longer than forecast;
- deterioration in general economic conditions, instability of global financial markets including the effect of macro political conditions;
- the UK's impending departure from the EU;
- possible contraction of the UK mortgage market negatively impacting loan book growth;
- UK banks' reaction to the Bank of England unwind of the Term Funding Scheme and other liquidity schemes;
- higher unemployment and lower property prices increasing impairments;
- new conduct or legal risk provisions; and
- risks stemming from regulatory change for example Payments Services Directive 2 (PSD2 open banking) and other payment system requirements, increasing regulatory enforcement and an increasingly litigious environment.

1.6.2 Regulatory deficiencies
The following section summarises the principal risks and uncertainties relating to deficiencies against regulatory requirements and expectations. The successful implementation of the Plan depends upon the ongoing support of regulators and supervising authorities regarding any continuing and intervening deficiencies to required regulatory standards.

1.6.2.1 Anticipated regulatory capital requirements
Following the completion of the 2017 Restructuring and Recapitalisation, the Group has achieved TCR and CRD IV buffer compliance (achieved from December 2017). This is supported by improvements the Group has achieved in model risk and pension risk management. Surplus to TCR and CRD IV buffer is expected across the life of the Plan. There is a risk that failure to keep within regulatory compliance or a change to regulatory expectations / levels could lead to deterioration of current capital positions reported.

The Bank received its binding 2019 MREL requirement from the Bank of England in 2018. The Plan targets MREL qualifying debt issuances across 2019, which is aligned to this requirement and further issuances across the planning period. There is a risk MREL qualifying debt may need to be issued earlier than the Plan currently assumes

1.6.2.2 Risks relating to resilience and recoverability of critical IT systems and controls
Operations are highly dependent on the proper functioning of IT and communication systems which comprise a complex array of legacy systems and some newer in-house and third party IT systems. Any significant failure to remedy the existing IT estate and operate legacy and new IT systems to meet the requirements of the strategy may adversely affect the future operational and financial performance of the business.

Although a large proportion of the critical services are now supported by technology that was migrated to new hardware in an IBM environment in 2017, which evidenced the return to FCA Threshold Conditions, a proportion of the current systems and technology remain on extended support arrangements or are nearing end-of-life (meaning that there is limited or no support provided by the vendor or specialist third-party supplier). Key transformation activity, due to complete during 2019, includes desktop transformation and IT separation from Co-operative Group, which is expected to reduce the Co-operative Bank's risk exposure in relation to this; however, there remains exposure to potential service disruptions, security weaknesses and operational inefficiencies to the legacy infrastructure and those aspects of the IT estate requiring further remediation include, but are not limited to, the desktop IT environment, loss of support of hardware and/or software and the telephony systems.

1.6.3 Other key risks
The following pages outline the other key financial and non-financial risks to which there is exposure as identified by the RMF. Any of these risks could result in an adverse effect on the business, operating results, financial condition, reputation and prospects. Where the definition of the risk has not already been provided in section 1.4, this is provided below. The governance arrangements detailed in section 1.5 provide oversight and challenge to each of the risks documented:

Principal risk	Risk description	Key mitigating actions
Credit risk	Managing this risk is a fundamental part of what a bank does. The exposure to this risk is reducing as higher risk lending is deleveraged; however, as with all other banks, there remains an exposure to macroeconomic and market-wide risks such as issues with the housing market and interest rate changes. The Plan assumes growth in new mortgage business volumes principally through mortgage intermediaries and is consequently exposed to risks relating to the relationships with such intermediaries. As a supplier of credit to the buy-to-let sector in the UK there is a risk many borrowers in the sector have yet to operate through an entire economic cycle, and any weakness in their credit quality may impact financial and operational performance.	Credit risk is managed through a framework that sets out policies and procedures covering both its measurement and management. There is a clear segregation of duties between transaction originators and approvers in the Risk function. All credit exposure limits are approved within a defined credit approval authority framework. Credit exposures are managed through diversification across products, geographies, client and customer segments.
Pension risk	The Group is a participating employer in Pace, which has both an active defined contribution section and a closed defined benefit section and is the sponsor of the Britannia Pension Scheme (BPS), which is a closed defined benefit scheme. Pension risk exposure has significantly reduced through 2018 through active management of both Pace and BPS – concluding with the full sectionalisation of the Pace scheme in August 2018. There is risk around macroeconomic volatility in relation to scheme investments (Pace and BPS), impact to CET1, Pillar 2a requirements and resulting in a material adverse effect on the business, financial condition, operating results and prospects. There are also risks the Group's covenant weakens resulting in the requirement to post more collateral and incurring associated costs of doing so and also if the schemes return to deficit unplanned provisions could be required for future payments.	Continued assessment of CET1 and pension Pillar 2a and 2b requirements will continue as per regulatory requirements with on-going oversight from senior management. In 2018 sectionalisation of Pace completed which removed the last man standing obligation for the Group.
Operational risk (including legal risk)	Operational risk levels remain elevated due to a number of specific issues such as manual processes, legacy systems and processes for which remediation continues. These are detailed above in section 1.6.2 or are referenced below: Systems of control have been historically weak, however in 2018 significant progress has been made to meet regulatory expectations in the overall effectiveness and embeddedness of the RMF. The focus through 2019 will be to ensure robust risk and control activities remain an integral part of the business as usual activities. There is an increased awareness of the RMF and work continues to further embed all elements. Key activity includes further embedding and evolution of the RMF through a normalisation process and collegiate working across all three lines of defence. There is an increase in dependency on outsourcing contracts and partners for critical infrastructure and operational capability, often at significant expense. There is a risk that any outsourcing arrangements are not properly scoped in determining business requirements; that the Group or the supplier may default on or otherwise seek to avoid contractual requirements; that the outsourcing is not properly managed or delivered upon as expected by the outsourced provider on an ongoing basis. In addition if any of the key outsourcing partners of crucial services cannot or will not continue to provide the outsourced functions and services for a sufficient time and with provision of adequate assistance to enable transfer to an alternative provider, then the business may face significant disruption to services and functions, reputational damage and possible regulatory scrutiny, which may adversely affect the business operating results and financial condition. The process of separating from Co-operative Group continues. A number of services are provided by Co-operative Group including critical IT services, personnel, and assets. Co-operative Group have terminated certain critical IT services on twelve months' notice. The ongoing separation project is complex and costs, resource and timely execution will need to be monitored. Furthermore the replacement arrangements may be more costly than the current arrangements with Co-operative Group. The Group is engaged in various legal proceedings in the United Kingdom, involving claims both by and against it, which arise in the ordinary course of business, including (but not limited to) debt collection, mortgage enforcement, consumer claims and contractual disputes. Whilst it is not expected that the ultimate resolution of any of these known legal proceedings have a material adverse effect on the operating results, cash flows or the financial position, and whilst provisions have been recognised for those cases where the Group is able reliably to estimate the probable loss where the probable loss is not *de minimis*, the outcome of litigation is difficult to predict and there is a risk that such provisions will be insufficient to cover the costs associated with such litigation.	Ongoing management, oversight and reporting in place across all three lines of defence. Litigation is managed to ensure that the financial and reputational risk to the Group is mitigated. Alternative services providers and contractual arrangements and ongoing migration of core technology.

Principal risk	Risk description	Key mitigating actions
Conduct risk (sub set of operational risk)	Conduct risk is defined as the risk that behaviours, offerings or interactions will result in inappropriate outcomes for customers, the Group or its staff, if appropriate market conditions are not observed. The Plan assumes no significant new conduct or legal risk provisions during the planning horizon. There is a risk of exposure to significant new conduct or legal risks, either by discovering significant new risk issues from legacy systems and controls or from regulatory changes imposed on banks generally. There is a risk that the cost of redress, remediation and project costs may be higher than current provisions and that expected over the life of the Plan. Specifically for Payment Protection Insurance (PPI), any change in the regulators current approach, any increase in complaint volumes and any additional requirements as a result of Plevin could increase the cost of overall remediation. Inherent risks remain 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 Group 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 provisions, costs and liabilities and/or reputational damage.	Proactive remediation of known conduct issues. Management will continue to monitor current conduct and legal risk exposures to ensure appropriate provisions are allocated. Monitoring developments in product related areas that attract increased focus from regulators, the courts and the Financial Ombudsmen Service (FOS), such as early repayment charges in both commercial and secured lending and variation of certain product terms and conditions.
Fraud risk (sub set of operational risk)	Fraud risk is defined as the risk to the business or customers from individuals using deception to dishonestly make a personal gain for themselves and/or create a loss for another. As with other banks, reflecting the increased use of technology in financial services, the business and customers are at a risk of cyber-attacks including attacks designed to overload systems (e.g. Distributed Denial of Service – DDoS). These risks are accentuated as the business increasingly digitalises products, services, key functions and distribution channels and as cyber-attacks become more sophisticated and prevalent. Inherent risks remain due to increased levels of card, account, identity, internal and other frauds, some of which are more sophisticated, organised and technology-led. This growth and increased sophistication increases the fraud risk and current systems based preventative measures may be less developed than those of other banks, may not prove effective in all circumstances to prevent fraud and, without further investment, may be increasingly exposed to fraud risk from increasingly sophisticated attacks by cyber-crime groups or fraudulent activity. The Group remains fully committed to combat the risks associated with cyber-crime and fraud. Failure to implement or progress critical strategic projects to enhance fraud control and reduce the reliance on static data for customer authentication could lead to increased levels of fraud.	Continued review and roll out of strategic projects throughout 2018 including: A pilot for behavioural biometrics in the Digital channel; Further research into the feasibility of handset or voice biometrics for the Telephone Channel; and Enhanced authentication using SMS verification for online Card Not Present transactions. Increased IT related defences deployed to detect DDoS at point of entry. Ongoing enhancement through 2019 will continue to be monitored to completion. Ongoing efforts and initiatives to increase customer awareness and customer's ability to avoid fraudulent attacks.
Financial reporting risk (sub set of operational risk)	The risk of reputational damage, sub-optimal business decision making, loss of investor confidence, prejudicing relationship with the regulatory authorities and/or financial loss caused by the incorrect or untimely delivery of regulatory, prudential, statutory, shareholder, taxation, management or other financial reporting IFRS 9 Financial Instruments is a significant new accounting standard which became effective on 1 January 2018. Applying the new classification and measurement principles and calculating expected credit losses was operationally complex, creating the risk that implementing IFRS 9 within the required timelines would have a detrimental impact on the timeliness and accuracy of financial reporting. Further changes to the Bank's financial reporting environment will occur during 2019 brought about by external regulatory change or the Bank's own transformation programme; these impacts are assessed, prioritised, and planned via governance to ensure risk is mitigated. The Group continues to recognise the complexity of its financial reporting as a risk; however, significant progress has continued to be made in 2018 to reduce and mitigate financial reporting risk, through further development and embedding of enhanced systems, process and reconciliation controls. Remaining risks are closely monitored and managed through the Bank's Risk Management Framework, including continual review and prioritisation of improvement activities.	There was close and detailed monitoring of the IFRS 9 delivery plan during 2018 including oversight by Audit Committee, with subsequent review being a significant element of the year-end audit. Focus will continue in 2019 on rationalising and improving data sources used for financial reporting, improving the IT systems including replacement of key sub-ledgers, further process improvement and continued enhancement of the regulatory reporting control framework in tandem with the Risk Management Framework embedding across the Bank. Continued oversight of financial reporting improvements and risk position will be undertaken by the independent Financial Reporting Risk team in conjunction with Senior Management.

Principal risk	Risk description	Key mitigating actions
Information and data risk (sub set of operational risk)	Information and data risk is associated with theft, loss, or misuse of information and data or the processing of poor quality information and data, resulting in customer or financial detriment, and legal or regulatory censure. Information and data risk is a sub set of operational risk. There are weaknesses in the framework for managing data, including adequate business and IT infrastructure, documented standards on ownership and quality of data (relating to customers and employees as well as proprietary data), as well as clear, documented standards and policies about the use of data. Failure to adequately maintain corporate records or to adequately maintain and protect customer and employee information could have a material adverse effect on the Group. Weaknesses in the data governance and data ownership framework have led to sub-optimal data management practices being adopted. These practices have resulted in difficulties in verifying the quality and usage of data. As a result, there are risks of inaccurate or incomplete financial and other reporting as well as the risk of inappropriate decision-making due to errors in underlying data.	In 2018 a refreshed framework for managing information and data, including the policy and control standard were approved and implemented with oversight provided by the Information and Data Risk Governance Forum and the Operational, Compliance & Financial Crime Risk Oversight Committee.
People risk (sub set of operational risk)	People risk is defined as the risk associated with inappropriate employee behaviour, inadequate resource (people, capability and frameworks), resulting in customer or financial detriment, and/or legal or regulatory censure. Retention of personnel remains a significant risk and has been heightened by the inability to use variable pay to reward performance through 2018, budgetary constraints limiting changes to fixed pay, scale and complexity of change, headcount reductions and ongoing pressure on cost reduction. Employee confidence and engagement levels continued to increase in 2018, with the engagement score now above the UK Retail banking industry benchmark. However, staff retention and engagement will continue be a significant challenge for the Executive team. A number of key initiatives continued during 2018 to tackle some key issues relating to people risk. The emerging talent strategy further advanced in 2018 with the continuation of the summer internship programme, apprenticeships and the graduate scheme. Further progress in strengthening the talent profile and senior level succession planning has been made during 2018, although ongoing structural changes will impact on succession strength. If Senior Executives or management leave earlier than planned, the Group may struggle to replace them with appropriate and sufficiently skilled candidates in a timely fashion, exposing the Group to operational disruption and potential delay in essential activities necessary for the Plan to be successfully delivered.	Further progress during 2018 has been made in strengthening the talent profile and senior level succession plans. However ongoing structural change will impact on succession strength, therefore planning for key critical roles will remain a focus in 2019. Employee turnover levels and employee engagement will continue to be monitored, particularly in relation to resignations from high performing colleagues.
Liquidity and funding risk	There are 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 if liquidity cannot be deployed as required. This may have an adverse effect on business, profitability and the ability to meet liabilities as they fall due. Risks associated with wholesale market access and volatility are also faced.	The liquidity position is well managed and the experience of previous stress events allows a good understanding of the real impact of a stress event on the liquidity positions. Liquidity and funding risk is managed primarily with respect to the Bank's Liquidity Risk Appetite and LCR across a 5 year Financial Planning horizon.

1.7 Emerging risks

Emerging risk	Definition/commentary	Key mitigating actions
Regulatory risk	Tight regulatory compliance deadlines have the potential to result in regulatory change programmes not meeting such deadlines, or to constrain time available for implementing strategic solutions.	Close ongoing monitoring of the regulatory portfolio through BResCo and associated Steering Committees ensuring the mobilisation of regulatory change is timely and effective and takes in to account the narrowing of the time gap between consultation and finalisation of rules by both the PRA and FCA.
Reputational risk	The Group considers that its reputation as an ethically led organisation is critical to the success of the Plan and actively seeks to manage and mitigate the risks that may impact its reputation. The Group and Bank continues to use the Co-operative name. The Co-operative Bank trademark belongs to the Bank; however in certain circumstances the right to use the term 'co-operative' could be challenged or removed. There is also a risk that its brand may be damaged as a result of matters affecting other co-operatives.	The Group seeks to protect its reputation and brand territory through consensual discussions and legal means where necessary. The Group also seeks to maintain an active dialogue with key stakeholders including Co-operatives UK and makes an active contribution to the co-operative movement.

1.8 Risk profile of the Bank

This table shows the business activities of each of the divisions of the Bank and the RWAs which reside in each division:

Retail	**Business activities:** • Deposits • Credits and lending to Retail (secured and unsecured)	**Loans and advances to customers (£m)** 16,028.7	**RWAs (£m)** Credit risk: 2,346.3 Operational risk: 395.4
Optimum	**Business activities:** • Closed residential mortgage book	**Loans and advances to customers (£m)** 524.5	**RWAs (£m)** Credit risk: 336.2 Operational risk: (31.5)[2]
Corporate (including Business Banking)	**Business activities**: • Lending to SME sector • Deposits to the SME sector • Closed historic Corporate lending	**Loans and advances to customers (£m)** 1,180.7	**RWAs (£m)** Credit risk: 971.6 Operational risk: 121.0
Treasury and Other	**Business activities:** • Cash flow, liquidity management, FX	**Credit risk balances (£m)** 2, 667.7[1]	**RWAs (£m)** Credit risk: 852.5 Operational risk: 62.0

1. Combination of loans and advances to banks, investment securities and derivative financial instruments and other assets.
2. The capital requirement for operational risk is calculated using three prior years' operating income; Legacy & Optimum income has been negative resulting in a negative calculation of RWA. CRR allows for positive income values in business line activity to be offset by negative income providing the overall total is not less than zero.

2. CAPITAL RISK

Overview - Unaudited

Capital resources are held to protect depositors, to cover inherent risks, to absorb unexpected losses, and to support the development of the business.

Capital adequacy is managed and calculated in accordance with CRD IV, implemented in the European Union through publication of CRR and a further iteration of the Capital Requirements Directive (CRD). Together this package of requirements is known as CRD IV and came into force from 1 January 2014. CRD IV disclosures in this and related documents are based on the Bank's interpretation of final published rules, including related EBA technical standards.

The strategic report and the 2018 Pillar 3 (Section 3 Capital Adequacy) report provide further detail on the capital risk in terms of:
- adequacy (including key capital highlights);
- stress testing;
- buffers;
- total resources;
- movement in resources;
- reconciliation to the balance sheet;
- Pillar 1 and RWA;
- RWA flows;
- reconciliation of balance sheet to credit risk exposure to exposure at default; and
- common leverage rate disclosures.

3. CREDIT RISK

3.1 Overview

Credit risk is managed through a framework that sets out policies and procedures covering both its measurement and management. There is a clear segregation of duties between transaction originators in the businesses and the approvers in the risk function. All credit exposure limits are approved within a defined credit approval authority framework. Credit exposures are managed through diversification across products, regional spread (UK), clients and customer segments.

3.1.1 Credit exposure

The following section explains the credit exposure in more detail. Within this section each table (where relevant) defines whether the information provided reflects IFRS 9 (the accounting standard which applies to the current 2018 financial year) or IAS 39 (the accounting standard in effect and adopted for previous financial years). Further information on the adoption of IFRS 9 is set out in note 1 of the financial statements.

We highlight the following information which is useful when reading the credit exposure section of the risk management report:
- cash and balances at central banks are credit exposures with the Bank of England and have been excluded from the analysis; and
- impaired and not impaired balances in the tables below are defined in the following sections on secured residential mortgage credit risk (3.2.1.1), unsecured retail credit risk (3.2.1.2) corporate credit risk (3.2.1.3), investment securities credit risk (3.2.2), loans and advances to banks (3.2.3), derivative financial instruments (3.2.4), wholesale credit risk (3.2.5) and other assets credit risk (3.2.6).

All amounts are stated in £m unless otherwise indicated and the disclosures cover both the Group and the Bank, unless otherwise stated.

The following table shows analysis of credit exposure by:
- carrying amounts by class of asset in the balance sheet;
- the gross credit risk exposure by class of asset (excluding allowance for losses but including credit commitments); and
- the net credit risk exposure by class of asset (including allowance for losses and credit commitments).

Audited – IFRS 9

2018	Loans and advances to banks	Loans and advances to customers	Investment securities	Derivative financial instruments	Other assets	Total
Analysis of balances in notes	13	14	15	16	18	
Gross balance	**485.8**	**17,786.6**	**1,935.0**	**192.2**	**54.7**	**20,454.3**
Less: allowance for losses	-	(52.7)	-	-	-	**(52.7)**
Net balance	**485.8**	**17,733.9**	**1,935.0**	**192.2**	**54.7**	**20,401.6**
Analysis of credit risk exposure						
Gross balance						
Stage 1 – 12 month ECL	485.8	16,592.2	1,931.5	-	21.8	**19,031.3**
Stage 2 – Lifetime ECL	-	552.0	-	-	-	**552.0**
Stage 3 – Lifetime ECL (credit impaired)	-	136.3	-	-	-	**136.3**
Purchased or credit impaired assets	-	355.3	-	-	-	**355.3**
FVTPL financial assets	-	150.8	3.5	192.2	32.9	**379.4**
	485.8	**17,786.6**	**1,935.0**	**192.2**	**54.7**	**20,454.3**
Credit commitments						
Stage 1 – 12 month ECL	-	2,221.9	-	-	-	**2,221.9**
Stage 2 – Lifetime ECL	-	22.1	-	-	-	**22.1**
Stage 3 – Lifetime ECL (credit impaired)	-	1.1	-	-	-	**1.1**
Purchased or credit impaired assets	-	2.3	-	-	-	**2.3**
FVTPL financial assets	-	-	-	-	-	**-**
	-	**2,247.4**	**-**	**-**	**-**	**2,247.4**
Gross credit risk exposure	**485.8**	**20,034.0**	**1,935.0**	**192.2**	**54.7**	**22,701.7**
Less: allowance for losses						
Stage 1 – 12 month ECL	-	(12.1)	-	-	-	**(12.1)**
Stage 2 – Lifetime ECL	-	(5.0)	-	-	-	**(5.0)**
Stage 3 – Lifetime ECL (credit impaired)	-	(30.7)	-	-	-	**(30.7)**
Purchased or credit impaired assets	-	(4.9)	-	-	-	**(4.9)**
FVTPL financial assets	-	-	-	-	-	**-**
	-	**(52.7)**	**-**	**-**	**-**	**(52.7)**
Net credit risk exposure	**485.8**	**19,981.3**	**1,935.0**	**192.2**	**54.7**	**22,649.0**

Included within the gross credit risk table above, are the following financial instruments which are classified at Fair Value Through Profit and Loss (FVTPL):

	Maximum exposure to credit risk	Carrying amount	Fair value of collateral held[1]
Derivatives	192.2	192.2	**-**
Other assets	32.9	32.9	**-**
Financial assets designated at FVTPL:			
Loans and advances to customers	150.8	150.8	65.0
Investment securities	3.5	3.5	-
	379.4	**379.4**	**65.0**

1. Fair value of collateral held for derivatives is only calculated on a net basis, so nil shown for Assets.

Audited – IAS 39

2017	Loans and advances to banks	Loans and advances to customers	Investment securities	Derivative financial instruments	Total
Analysis of balance in notes	13	14	15	16	
Gross balance	574.8	16,824.5	2,387.7	232.4	20,019.4
Less: allowance for losses	-	(80.0)	-	-	(80.0)
	574.8	16,744.5	2,387.7	232.4	19,939.4
Analysis of credit risk exposure					
Not impaired	574.8	16,427.6	2,387.7	232.4	19,622.5
Impaired	-	396.9	-	-	396.9
	574.8	16,824.5	2,387.7	232.4	20,019.4
Credit commitments (incl. derivative and contingent liabilities)	-	2,411.0	-	-	2,411.0
Gross credit risk exposure	574.8	19,235.5	2,387.7	232.4	22,430.4
Less: allowance for losses	-	(80.0)	-	-	(80.0)
Net credit risk exposure	574.8	19,155.5	2,387.7	232.4	22,350.4

3.2 Credit risk management

The following sections provide further analysis and disclosure of the Bank's credit risk associated with:
3.2.1 Loans and advances to customers;
3.2.2 Investment securities;
3.2.3 Loans and advances to banks;
3.2.4 Derivative financial instruments;
3.2.5 Wholesale credit risk; and
3.2.6 Other assets.

3.2.1 Loans and advances to customers

The tables below analyse the credit risk profile of the loans and advances to customers analysed by:
3.2.1.1 Secured residential mortgages credit risk;
3.2.1.2 Retail unsecured credit risk; and
3.2.1.3 Corporate credit risk.

In the detailed financial review and in the notes to the financial statements, retail is a combination of retail secured and retail unsecured.

The risk function manages and reports through gross customer balances and exposure by impairment classification. For accounting purposes, we reflect balances which include other adjustments (for example accrued interest, day zero completions, fair value adjustments and effective interest rate adjustments). A reconciliation between the two is included in the next table.

Customer exposures are predominantly within the UK. As at 31 December the value of overseas exposure is £37.8m (2017: £56.1m) consisting of corporate (£10.8m) and retail unsecured (£27.0m). This represents 0.2% (2017: 0.3%) of the total credit risk exposure.

Under IFRS 9, an Expected Credit Loss (ECL) is calculated for the drawn element of the book (gross loans and advances) plus an ECL for the undrawn (credit commitments excluding the derivative). The drawn and undrawn ECL is set against the gross loans and advances balance to give the net loans and advances (see note 1.3). Comparatives have not been restated for the change in accounting standard as permitted by the transition rules of IFRS 9.

The disclosures in the sections (3.2.1.1 Secured residential mortgage credit risk, 3.2.1.2 Unsecured retail credit risk and 3.2.1.3 Corporate credit risk) are based on:

- gross customer balance (except for the coverage ratio which uses the gross loans & advances).
- gross customer exposure (which includes the gross customer balance plus credit commitments).
- impairment (which includes allowance for losses relating to drawn ECL plus undrawn ECL).

Audited – IFRS 9

2018	Secured residential: Retail secured	Secured residential: Optimum	Retail unsecured	Corporate	Total
Analysis of balances in note 14					
Gross loans & advances	15,564.4	529.5	489.1	1,203.6	**17,786.6**
Less: allowance for losses	(12.3)	(5.0)	(12.5)	(22.9)	**(52.7)**
Net loans & advances	**15,552.1**	**524.5**	**476.6**	**1,180.7**	**17,733.9**
Analysis of credit risk exposure:					
Net loans & advances					
Stage 1 - 12 month ECL	14,971.2	240.4	409.0	971.6	**16,592.2**
Stage 2 - Lifetime ECL	405.3	33.4	65.8	47.5	**552.0**
Stage 3 - Lifetime ECL (credit impaired)	67.3	20.0	11.5	37.5	**136.3**
Purchased or Originated Credit Impaired (POCI)	115.5	235.7	2.8	1.3	**355.3**
FVTPL financial assets	5.1	-	-	145.7	**150.8**
	15,564.4	**529.5**	**489.1**	**1,203.6**	**17,786.6**
Credit commitments (incl. derivative and contingencies)					
Stage 1 - 12 month ECL	689.0	-	1,285.8	247.1	**2,221.9**
Stage 2 - Lifetime ECL	-	-	20.7	1.4	**22.1**
Stage 3 - Lifetime ECL (credit impaired)	-	-	0.8	0.3	**1.1**
POCI	-	-	2.3	-	**2.3**
FVTPL financial assets	-	-	-	-	**-**
	689.0	**-**	**1,309.6**	**248.8**	**2,247.4**
Gross credit risk exposure	**16,253.4**	**529.5**	**1,798.7**	**1,452.4**	**20,034.0**
Less: allowance for losses					
Stage 1 - 12 month ECL	(8.0)	(0.6)	(1.4)	(2.1)	**(12.1)**
Stage 2 - Lifetime ECL	(1.4)	(0.2)	(2.8)	(0.6)	**(5.0)**
Stage 3 - Lifetime ECL (credit impaired)	(2.7)	(1.0)	(8.1)	(18.9)	**(30.7)**
POCI	(0.2)	(3.2)	(0.2)	(1.3)	**(4.9)**
FVTPL financial assets	-	-	-	-	**-**
	(12.3)	**(5.0)**	**(12.5)**	**(22.9)**	**(52.7)**
Net credit risk exposure	**16,241.1**	**524.5**	**1,786.2**	**1,429.5**	**19,981.3**
Net credit risk exposure relating to assets classified as:					
Amortised cost	16,236.0	524.5	1,786.2	1,283.8	**19,830.5**
FVOCI	5.1	-	-	145.7	**150.8**
	16,241.1	**524.5**	**1,786.2**	**1,429.5**	**19,981.3**
Reconciliation of accounting to customer balances					
Gross loans & advances	15,564.4	529.5	489.1	1,203.6	**17,786.6**
Other accounting adjustments	(71.6)	-	(13.1)	(43.1)	**(127.8)**
Gross customer balances	**15,492.8**	**529.5**	**476.0**	**1,160.5**	**17,658.8**
Reporting of tables in 3.2.1:					
1) Gross customer balance[1]	**15,492.8**	**529.5**	**476.0**	**1,160.5**	**17,658.8**
add in credit commitments	689.0	-	1,309.6	248.8	2,247.4
2) Gross customer exposure[2]	**16,181.8**	**529.5**	**1,785.6**	**1,409.3**	**19,906.2**
less FVTPL balances[3]	(2.6)	-	-	(121.3)	(123.9)
3) Gross customer exposure (IFRS 9 stages)[4]	**16,179.2**	**529.5**	**1,785.6**	**1,288.0**	**19,782.3**

1. Used for reporting portfolio analysis within the Retail secured book as this excludes pipeline commitments. This value differs from the Loans and Advances values as it excludes other accounting adjustments.
2. Used for reporting of the total Retail secured, unsecured books and Corporate. Note that the ratio analysis is based on the gross loans and advances.
3. The FVTPL adjustment is different to the FVTPL values within table as some of the values are within the other accounting adjustments (which are already excluded).
4. Used for the reporting of IFRS 9 stage analysis.

Audited – IAS 39

2017	Secured residential: Retail secured	Secured residential: Optimum	Retail unsecured	Corporate	Total
Analysis of balances in note 14					
Gross loans and advances	14,159.8	593.7	592.3	1,478.7	16,824.5
Less: allowance for losses	(10.5)	(8.0)	(30.6)	(30.9)	(80.0)
	14,149.3	585.7	561.7	1,447.8	16,744.5
Analysis of credit risk exposure					
Not impaired	14,024.0	484.4	549.2	1,370.0	16,427.6
Impaired	135.8	109.3	43.1	108.7	396.9
	14,159.8	593.7	592.3	1,478.7	16,824.5
Credit commitments (incl. contingent liabilities & derivatives)	697.3	-	1,437.6	276.1	2,411.0
Gross credit risk exposure	14,857.1	593.7	2,029.9	1,754.8	19,235.5
Less: allowance for losses	(10.5)	(8.0)	(30.6)	(30.9)	(80.0)
Net credit risk exposure	14,846.6	585.7	1,999.3	1,723.9	19,155.5
Reconciliation of accounting to customer balances					
Gross loans and advances	14,159.8	593.7	592.3	1,478.7	16,824.5
Accounting adjustments	(56.5)	(0.1)	(9.0)	(39.4)	(105.0)
Gross customer balances	14,103.3	593.6	583.3	1,439.3	16,719.5

3.2.1.1 Secured residential mortgage credit risk

The secured residential mortgage book comprises of two portfolios:

- Retail secured – this comprises mainly prime residential mortgages alongside Buy-to-Let (BTL) mortgages. All new completions are in this portfolio (see acquisition and account management for details); and
- Optimum – a closed book of predominantly interest only intermediary and acquired residential mortgage books. These loans include a range of asset types, including prime residential (both income verified and self-certified), BTL and non-conforming mortgages. The book was closed in 2009 and now stands at £0.5bn due to a combination of run-off and a series of securitisations under the Warwick Finance name.

Unless stated otherwise all analysis is based on gross customer balances.

Acquisition and account management

Mortgages are loans to customers secured by a first charge over a residential property, mainly originated via intermediaries under the Platform brand with a more limited value directly to customers under The Co-operative Bank and Britannia brands. In February 2018, the Bank ceased to offer new direct business via the telephone and in branches. Of the mortgage completions (including ports) in the year to 31 December 2018, 97.8% (2017: 94.6%) was originated through intermediaries and 2.2% (2017: 5.4%) was directly originated.

Platform currently originates a combination of prime residential mortgages and BTL loans. Historically, these loans have been advanced on a capital and interest payment basis, where the loan is repaid over the term of the loan, or interest only, where the capital element of the loan is repayable at the end of the term. All new advances are on a capital repayment basis with the exception of BTL lending and existing interest only loans for customers moving home.

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

Risk in the portfolio is recalculated monthly, using internally-developed behavioural models. This process is also used to determine the amount of capital which is required to be held for individual loans.

The next table shows total mortgage completions in the period (including cases where customers have ported their mortgage from one property to another), analysed by Loan-to-Value (LTV) and repayment method.

Unaudited

	2018			2017		
	Amount advanced	**Average LTV %**	**Interest only %**	Amount advanced	Average LTV %[1]	Interest only %
Britannia & Co-operative prime	92.7	59.6	3.4	181.5	63.2	2.2
Platform prime	4,040.9	72.3	-	3,010.2	72.0	-
Total prime	**4,133.6**	**72.0**	**0.1**	3,191.7	71.5	0.1
Buy-to-let	149.3	61.3	83.8	174.8	59.9	84.0
Total completions (including ports)	**4,282.9**	**71.6**	**3.0**	3,366.5	70.9	4.5

1. Restated to show LTV on a weighted average balance basis.

Total mortgage completions have increased in 2018 driven by a rise in Platform prime lending.

The table below shows gross customer balances (maximum exposure to credit risk including credit commitments) analysed by the number of years after the initial origination:

Audited

	2018		2017	
	Retail secured	**Optimum**	Retail secured	Optimum
< 1 year [1]	4,388.8	-	3,527.5	-
1-4 years	6,814.3	-	5,320.3	-
4-7 years	1,294.8	-	1,807.3	-
7+ years	2,994.9	529.5	3,448.2	593.6
Total	**15,492.8**	**529.5**	14,103.3	593.6

1. The gross customer balances of accounts originated in the year, include a small segment of legacy accounts with a recent variation such as transfer of equity, or taking additional borrowing.

Portfolio analysis

The following tables show the retail secured and Optimum total customer balances analysed by a number of key risk measurements. The portfolio has grown by £1.3bn with all the growth in the retail secured book. This has been driven through Platform lending.

a) LTV and repayment type

The table shows gross customer balances analysed by indexed LTV bandings (with interest only including mortgages on a part repayment/part interest basis). Total interest only balances have reduced by £0.4bn. At the same time, total capital and repayment balances have increased substantially due to the higher volumes of Platform residential lending. The proportion of total balances with current LTV less than 50% has reduced in the year to 36.3% (2017: 41.8%); driven largely by a portfolio shift towards new Platform lending that has a higher LTV distribution.

Audited

2018	**Retail secured**			**Optimum**			
LTV %	**Capital repayment**	**Interest only**	**Total**	**Capital repayment**	**Interest only**	**Total**	**Total**
Less than 50%	4,345.9	1,253.8	**5,599.7**	52.4	168.6	**221.0**	**5,820.7**
50% to 60%	1,923.5	546.2	**2,469.7**	7.0	107.4	**114.4**	**2,584.1**
60% to 70%	2,391.0	402.7	**2,793.7**	3.8	99.4	**103.2**	**2,896.9**
70% to 80%	2,551.9	118.7	**2,670.6**	0.8	57.7	**58.5**	**2,729.1**
80% to 90%	1,757.8	28.1	**1,785.9**	0.3	21.2	**21.5**	**1,807.4**
90% to 100%	160.7	6.9	**167.6**	-	7.3	**7.3**	**174.9**
Greater than or equal to 100%	0.8	4.8	**5.6**	-	3.6	**3.6**	**9.2**
	13,131.6	**2,361.2**	**15,492.8**	**64.3**	**465.2**	**529.5**	**16,022.3**

2017	Retail secured			Optimum			
LTV %	Capital repayment	Interest only	Total	Capital repayment	Interest only	Total	Total
Less than 50%	4,460.2	1,438.4	5,898.6	59.6	178.3	237.9	6,136.5
50% to 60%	1,763.5	574.2	2,337.7	10.2	116.0	126.2	2,463.9
60% to 70%	2,076.4	504.8	2,581.2	4.1	102.5	106.6	2,687.8
70% to 80%	1,853.2	121.7	1,974.9	2.3	79.2	81.5	2,056.4
80% to 90%	1,168.2	36.9	1,205.1	0.5	26.3	26.8	1,231.9
90% to 100%	84.6	11.8	96.4	0.2	7.7	7.9	104.3
Greater than or equal to 100%	1.5	7.9	9.4	-	6.7	6.7	16.1
	11,407.6	2,695.7	14,103.3	76.9	516.7	593.6	14,696.9

Interest only balances are contractually due to mature as shown below:

Unaudited

2018	**< 1 year**	**1-5 years**	**5-10 years**	**10-20 years**	**20+ years**	**Total**
Retail secured	94.2	298.9	537.0	1,032.0	399.1	**2,361.2**
Optimum	35.3	54.7	129.5	245.6	0.1	**465.2**
	129.5	**353.6**	**666.5**	**1,277.6**	**399.2**	**2,826.4**

2017	< 1 year	1-5 years	5-10 years	10-20 years	20+ years	Total
Retail secured	116.0	320.7	570.5	1,221.4	467.1	2,695.7
Optimum	43.8	54.0	117.0	300.0	1.9	516.7
	159.8	374.7	687.5	1,521.4	469.0	3,212.4

b) Mortgage type

The table below shows gross customer balances for mortgages analysed by asset class, the LTV shown is the current indexed average percentage. Over 97% of the total book is classified as prime or BTL mortgages. The higher risk self-certified, almost prime and non-conforming account for only total 3% of the book.

Unaudited

	Retail secured			**Optimum**		
2018	**Gross customer balance**	**Average LTV %**	**Interest only %**	**Gross customer balance**	**Average LTV %**	**Interest only %**
Prime residential	14,316.9	56.0	9.2	32.3	54.1	81.9
Buy-to-let	1,119.2	55.1	89.4	129.6	51.2	92.0
Self-certified	38.3	37.3	90.0	197.8	51.0	93.3
Almost prime	17.7	37.4	34.3	41.6	66.5	86.6
Non-conforming	0.7	49.0	52.8	128.2	52.3	77.1
	15,492.8	**55.9**	**15.2**	**529.5**	**52.8**	**87.8**

Unaudited

	Retail secured			Optimum		
2017	Gross customer balance	Average LTV %	Interest only %	Gross customer balance	Average LTV %	Interest only %
Prime residential	12,885.9	52.6	12.6	37.5	54.9	81.7
Buy-to-let	1,149.3	56.0	89.4	140.0	52.0	91.2
Self-certified	45.4	36.6	89.5	225.4	52.2	92.7
Almost prime	21.8	38.8	34.5	46.5	68.3	86.0
Non-conforming	0.9	53.0	55.4	144.2	53.4	75.9
	14,103.3	52.8	19.1	593.6	53.9	87.0

c) UK regional distribution

The table below shows the analysis of gross customer balances by UK regions:

Audited

	2018		2017	
Gross customer balances by region	**Retail secured**	**Optimum**	Retail secured	Optimum
London & South East	6,473.6	258.8	6,126.5	292.5
Northern England	3,250.9	105.7	2,801.8	117.2
Midlands & East Anglia	3,172.5	85.9	2,834.9	96.0
Wales & South West	1,770.7	56.7	1,617.4	62.7
Other	825.1	22.4	722.7	25.2
	15,492.8	**529.5**	14,103.3	593.6

Lending in the London and South East accounts for 41.8% of overall lending (excluding Optimum), a slight reduction since 2017 (2017: 43.4%). The next table compares the LTVs in the London and South East region against the whole country. This shows that the London and South East has a higher proportion of mortgages in the lowest LTV bands:

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	Retail secured				**Optimum**			
	2018		2017		**2018**		2017	
	London & South East	**All Regions**	London & South East	All Regions	**London & South East**	**All Regions**	London & South East	All Regions
LTV banding	**%**	**%**	%	%	**%**	**%**	%	%
Less than 50%	39.6%	36.1%	44.0%	41.8%	53.1%	41.7%	50.8%	40.1%
50% to 80%	50.6%	51.3%	48.0%	48.9%	46.1%	52.1%	48.3%	52.9%
Less than 80%	**90.2%**	**87.4%**	92.0%	90.7%	**99.2%**	**93.8%**	99.1%	93.0%
80% to 90%	9.5%	11.5%	7.6%	8.6%	0.4%	4.1%	0.3%	4.5%
Greater than 90%	0.3%	1.1%	0.4%	0.7%	0.4%	2.1%	0.6%	2.5%
	100.0%	**100.0%**	100.0%	100.0%	**100.0%**	**100.0%**	100.0%	100.0%

Collateral

Mortgages are secured by a first charge over the property being purchased or re-mortgaged and this security is referred to as collateral. Valuation of the property is either assessed by a Royal Institution of Chartered Surveyors (RICS) certified surveyor from the Bank's approved panel, or through the use of an Automated Valuation Model (AVM).

The Bank reassesses the valuation of collateral for the non-default book on a quarterly basis using a regional property price index. There has been no significant change in the overall quality of the collateral held during the year.

The table below analyses the indexed value of property collateral held against mortgage portfolios:

Audited - IFRS 9

	Retail secured					**Optimum**				
2018	**Gross customer balance**	**Impairment allowance**	**Net exposure**	**Collateral**	**Cover %**	**Gross customer balance**	**Impairment allowance**	**Net exposure**	**Collateral**	**Cover %**
Stage 1	15,591.1	(8.0)	**15,583.1**	15,589.0	**100.0**	240.4	(0.6)	**239.8**	240.3	**100.0**
Stage 2	405.3	(1.4)	**403.9**	405.0	**99.9**	33.4	(0.2)	**33.2**	33.2	**99.4**
Total not impaired	**15,996.4**	**(9.4)**	**15,987.0**	**15,994.0**	**100.0**	**273.8**	**(0.8)**	**273.0**	**273.5**	**99.9**
Stage 3	67.3	(2.7)	**64.6**	67.1	**99.7**	20.0	(1.0)	**19.0**	20.0	**100.0**
POCI	115.5	(0.2)	**115.3**	115.5	**100.0**	235.7	(3.2)	**232.5**	235.5	**99.9**
Total impaired	**182.8**	**(2.9)**	**179.9**	**182.6**	**99.9**	**255.7**	**(4.2)**	**251.5**	**255.5**	**99.9**
Total	**16,179.2**	**(12.3)**	**16,166.9**	**16,176.6**	**100.0**	**529.5**	**(5.0)**	**524.5**	**529.0**	**99.9**

Audited - IAS 39

	Retail secured			Optimum		
2017	Gross customer balance	Collateral	Cover %	Gross customer balance	Collateral	Cover %
Not impaired	13,967.5	13,964.7	100.0	484.3	484.0	99.9
Impaired	135.8	135.7	99.9	109.3	108.7	99.5
	14,103.3	14,100.4	100.0	593.6	592.7	99.8

In the tables above, collateral is constrained to a maximum of 100% of the exposure to each customer to correctly reflect the maximum protection available to the Bank. For the purposes of determining capital and impairment, appropriate forced sale discount assumptions are applied to collateral.

In accordance with transitional provisions in IFRS 9, comparative figures have not been restated. See note 1 for details of changes in accounting policy.

Impairment

a) 2018 – IFRS 9

The Bank assesses the ECL on a forward-looking basis for debt instruments carried at amortised cost and FVOCI, for exposures related to loan commitments, and financial guarantee contracts. The Bank applies the IFRS 9 three-stage approach to model ECL. See note 1 to the financial statements for the recognition criteria applicable to each of the three stages.

b) 2017 – IAS 39

Where objective evidence of impairment has been observed as a result of one or more loss events, the impairment held at the balance sheet date is defined as identified impairment. Loans under forbearance are subject to a specific identified impairment assessment. Loans where no objective evidence has been observed are collectively assessed for unidentified impairment (i.e. where a loss event has occurred, but objective evidence of impairment has not yet been identified).

Impaired balances are defined as one or more payments past due, forborne or in default (over six months past due, possession, litigation, bankruptcy or Law of Property Act (LPA) receiver appointed).

The tables below show the movements in the gross carrying amount and expected credit loss allowance during the year:

Audited – IFRS 9

Retail secured – non-credit impaired	**Stage 1**		**Stage 2**		**Total**	
2018	**Gross customer balance**	**Allowance for losses**	**Gross customer balance**	**Allowance for losses**	**Gross customer balance**	**Allowance for losses**
At the beginning of the year adjusted for IFRS 9	14,117.3	4.5	454.5	0.5	**14,571.8**	**5.0**
Changes in assets which transitioned during the year:[1]						
To lifetime ECL	(142.9)	-	134.2	0.4	**(8.7)**	**0.4**
To credit impaired	(9.5)	-	(12.8)	(0.1)	**(22.3)**	**(0.1)**
To 12 month ECL	80.7	0.1	(85.4)	(0.1)	**(4.7)**	**-**
From credit impaired	3.7	-	3.1	-	**6.8**	**-**
Net changes in assets which transitioned during the year:	**(68.0)**	**0.1**	**39.1**	**0.2**	**(28.9)**	**0.3**
Other charge/(releases):						
New assets originated or purchased	5,076.6	2.6	-	-	**5,076.6**	**2.6**
Other changes to risk parameters [2]	(3,534.8)	0.8	(87.9)	0.8	**(3,622.7)**	**1.6**
	1,541.8	**3.4**	**(87.9)**	**0.8**	**1,453.9**	**4.2**
Assets written off	-	-	(0.4)	(0.1)	**(0.4)**	**(0.1)**
At the end of the year	**15,591.1**	**8.0**	**405.3**	**1.4**	**15,996.4**	**9.4**

Retail secured – credit impaired	**Stage 3**		**POCI**		**Total**	
2018	**Gross customer balance**	**Allowance for losses**	**Gross customer balance**	**Allowance for losses**	**Gross customer balance**	**Allowance for losses**
At the beginning of the year adjusted for IFRS 9	82.1	6.3	143.2	0.2	225.3	**6.5**
Changes in assets which transitioned during the year:[1]						
To lifetime ECL	-	-	**-**	**-**	**-**	**-**
To credit impaired	21.3	0.8	**-**	**-**	**21.3**	**0.8**
To 12 month ECL	-	-	**-**	**-**	**-**	**-**
From credit impaired	(7.5)	(0.4)	**-**	**-**	**(7.5)**	**(0.4)**
Net changes in assets which transitioned during the year:	**13.8**	**0.4**	**-**	**-**	**13.8**	**0.4**
Other charge/(releases):						
New assets originated or purchased	-	-	**-**	**-**	**-**	**-**
Other changes to risk parameters [2]	(26.2)	(3.5)	(27.7)	**-**	**(53.9)**	**(3.5)**
	(26.2)	**(3.5)**	**(27.7)**	**-**	**(53.9)**	**(3.5)**
Assets written off	(2.4)	(0.5)	**-**	**-**	**(2.4)**	**(0.5)**
At the end of the year	**67.3**	**2.7**	**115.5**	**0.2**	**182.8**	**2.9**

Optimum – non-credit impaired	Stage 1		Stage 2		Total	
2018	Gross customer balance	Allowance for losses	Gross customer balance	Allowance for losses	Gross customer balance	Allowance for losses
At the beginning of the year adjusted for IFRS 9	244.5	-	38.1	0.1	**282.6**	**0.1**
Changes in assets which transitioned during the year:1						
To lifetime ECL	(6.3)	-	6.3	-	**-**	**-**
To credit impaired	(2.2)	-	(2.0)	-	**(4.2)**	**-**
To 12 month ECL	5.0	-	(5.1)	-	**(0.1)**	**-**
From credit impaired	1.8	-	1.4	0.1	**3.2**	**0.1**
Net changes in assets which transitioned during the year:	**(1.7)**	**-**	**0.6**	**0.1**	**(1.1)**	**0.1**
Other charge/(releases):						
New assets originated or purchased	7.5	-	-	-	**7.5**	**-**
Other changes to risk parameters 2	(9.9)	0.6	(5.3)	-	**(15.2)**	**0.6**
	(2.4)	**0.6**	**(5.3)**	**-**	**(7.7)**	**0.6**
Assets written off	-	-	-	-	**-**	**-**
At the end of the year	**240.4**	**0.6**	**33.4**	**0.2**	**273.8**	**0.8**

Optimum – credit impaired	Stage 3		POCI		Total	
2018	Gross customer balance	Allowance for losses	Gross customer balance	Allowance for losses	Gross customer balance	Allowance for losses
At the beginning of the year adjusted for IFRS 9	31.0	2.3	280.0	5.6	**311.0**	**7.9**
Changes in assets which transitioned during the year:[1]						
To lifetime ECL	-	-	-	-	**-**	**-**
To credit impaired	3.9	0.2	-	-	**3.9**	**0.2**
To 12 month ECL	-	-	-	-	**-**	**-**
From credit impaired	(3.2)	(0.3)	-	-	**(3.2)**	**(0.3)**
Net changes in assets which transitioned during the year:	**0.7**	**(0.1)**	**-**	**-**	**0.7**	**(0.1)**
Other charge/(releases):						
New assets originated or purchased	-	-	-	-	**-**	**-**
Other changes to risk parameters [2]	(10.7)	(0.8)	(40.8)	(1.4)	**(51.5)**	**(2.2)**
	(10.7)	**(0.8)**	**(40.8)**	**(1.4)**	**(51.5)**	**(2.2)**
Assets written off	(1.0)	(0.4)	(3.5)	(1.0)	**(4.5)**	**(1.4)**
At the end of the year	**20.0**	**1.0**	**235.7**	**3.2**	**255.7**	**4.2**

Total residential secured mortgages	Retail secured		Optimum		Total	
2018	Gross customer balance	Allowance for losses	Gross customer balance	Allowance for losses	Gross customer balance	Allowance for losses
At the beginning of the year adjusted for IFRS 9	14,797.1	11.5	593.6	8.0	**15,390.7**	**19.5**
Changes in assets which transitioned during the year:[1]						
To lifetime ECL	(8.7)	0.4	-	-	**(8.7)**	**0.4**
To credit impaired	(1.0)	0.7	(0.3)	0.2	**(1.3)**	**0.9**
To 12 month ECL	(4.7)	-	(0.1)	-	**(4.8)**	**-**
From credit impaired	(0.7)	(0.4)	-	(0.2)	**(0.7)**	**(0.6)**
Net changes in assets which transitioned during the year:	**(15.1)**	**0.7**	**(0.4)**	**-**	**(15.5)**	**0.7**
Other charge/(releases) :						
New assets originated or purchased	5,076.6	2.6	7.5	-	**5,084.1**	**2.6**
Other changes to risk parameters [2]	(3,676.6)	(1.9)	(66.7)	(1.6)	**(3,743.3)**	**(3.5)**
	1,400.0	**0.7**	**(59.2)**	**(1.6)**	**1,340.8**	**(0.9)**
Assets written off	(2.8)	(0.6)	(4.5)	(1.4)	**(7.3)**	**(2.0)**
At the end of the year	**16,179.2**	**12.3**	**529.5**	**5.0**	**16,708.7**	**17.3**

1. Includes the impact of both transition and repayments on assets which transitioned during the year.
2. Includes repayments (other than those related to assets which transitioned during the year) and changes due to other model inputs.

Audited – IAS 39

2017	Retail secured	Optimum
Impaired balance at start of the year	170.0	296.5
Classified as impaired during the year	49.5	29.8
Transferred to not impaired during the year	(42.7)	(24.1)
Net repayments and other	(41.0)	(192.9)
Impaired balance at the end of the year	135.8	109.3

The above table shows that the retail secured book grew during the year by £1.4bn alongside a £0.8m increase in the ECL. The net impact of the transfers is a £0.7m increase in ECL with a small net movement into impaired assets. The net impact of the new loans (including pipeline commitments) (£5.1bn) less redemptions (£3.7bn) is a £0.7m increase in ECL. These increases are offset by write offs of £2.8m resulting in a £0.6m reduction in the ECL.

The Optimum book has declined by £64m (the book is closed and in run-off). This has driven £1.6m of the total £3.0m reduction in the total ECL. The other declines come from the £4.5m write offs resulting in a £1.4m decrease in ECL.

There has been minimal impact due to the macroeconomic scenarios and no changes to the model.

The basis of calculation of the reconciliation of opening and closing balances and the allowance for loan losses is calculated in the sequential order in the table above. The calculation of the reconciliation of transfers between stages is performed by comparing 1 January 2018 opening values compared to closing 31 December 2018 month-end values; which includes the impact of repayments. New assets originated or purchased in the table above, include loan commitments. Changes to risk parameters (model inputs) in the table above include repayments (excluding those in transfers) plus other model-related movements. Assets de-recognised disclosed in the table above, only includes write offs.

The write offs for retail secured and Optimum loans for 2018 were £2.8m and £4.5m respectively. At the point of write off, the Bank has no further pro-active debt recovery activity since recovery of the outstanding balance is deemed unlikely, uneconomical or inappropriate. The exception is mortgage shortfall balances, which are 100% provided, but can still be pursued for payment.

Ratios – impaired assets and allowance for losses

The following table shows the impaired and coverage ratios (allowance for losses over impaired assets or total book). Note that the ratios are based on the balance sheet values (including other accounting adjustments) and that 2018 is reported on an IFRS 9 basis and 2017 is on an IAS 39 basis; so the two are not always directly comparable.

Retail secured	2018					2017
	Stage 1/FVTPL	Stage 2	Stage 3	POCI	Total	Total
Gross loans and advances to customers	14,976.3	405.3	67.3	115.5	**15,564.4**	14,159.8
of which impaired	-	-	67.3	115.5	**182.8**	135.8
Impaired as a % of gross loans and advances to customers	**0.0%**	**0.0%**	**100.0%**	**100.0%**	**1.2%**	1.0%
Allowance for losses	8.0	1.4	2.7	0.2	**12.3**	10.5
Coverage - impaired assets	**N/a**	**N/a**	**4.0%**	**0.2%**	**6.7%**	7.7%
Coverage - total book	**0.05%**	**0.35%**	**4.01%**	**0.17%**	**0.08%**	0.07%

Overall, the retail secured book has very low levels of impaired assets and ECL, which is reflected in the low impaired and coverage ratios. Retail has seen an increase of £1.8m in the ECL alongside an additional £1.4bn of net assets. Overall, the coverage of the total book has remained broadly stable at 0.08% whilst the coverage of the impaired book has declined as a number of POCI cases are now included as impaired under IFRS 9 (under IAS 39 these would have been non-impaired).

Optimum	2018					2017
	Stage 1	Stage 2	Stage 3	POCI	Total	Total
Gross loans and advances to customers	240.4	33.4	20.0	235.7	**529.5**	593.7
of which impaired	-	-	20.0	235.7	**255.7**	109.3
Impaired as a % of gross loans and advances to customers	**0.0%**	**0.0%**	**100.0%**	**100.0%**	**48.3%**	18.4%
allowance for losses	0.6	0.2	1.0	3.2	**5.0**	8.0
Coverage - impaired assets	**N/a**	**N/a**	**5.0%**	**1.4%**	**2.0%**	7.3%
Coverage - total book	**0.25%**	**0.60%**	**5.00%**	**1.36%**	**0.94%**	1.35%

The optimum book has had a small decline over the year and the ECL has also declined. However, the impaired ratio has increased due to the POCI cases now being included as impaired under IFRS 9 (whilst under IAS 39 being treated as non-impaired). These POCI balances are generally better performing and as such do not have high levels of ECL. There has been an associated decrease in the coverage ratio for both the impaired and total book.

Risk grade

The table below analyses the credit risk exposure by grade of retail secured mortgages:

Unaudited – IFRS 9

2018	Retail secured				
Credit grade	**Stage 1**	**Stage 2**	**Stage 3**	**POCI**	**Total**
0.00 to 0.04%	1,469.8	86.3	-	-	**1,556.1**
0.04 to 0.07%	1,787.0	79.6	-	-	**1,866.6**
0.07 to 0.31%	3,327.8	55.3	-	37.3	**3,420.4**
0.31 to 1.00%	6,608.5	78.6	-	45.5	**6,732.6**
1.00 to 3.00%	1,656.3	50.1	-	22.5	**1,728.9**
3.00 to 15.32%	603.5	25.6	-	2.3	**631.4**
15.32 to 99.99%	133.0	25.4	-	3.9	**162.3**
100.0%	5.2	4.4	67.3	4.0	**80.9**
Gross exposure	**15,591.1**	**405.3**	**67.3**	**115.5**	**16,179.2**
Less: allowance for losses	(8.0)	(1.4)	(2.7)	(0.2)	**(12.3)**
Net balance	**15,583.1**	**403.9**	**64.6**	**115.3**	**16,166.9**

	Optimum				
Credit grade	**Stage 1**	**Stage 2**	**Stage 3**	**POCI**	**Total**
0.00 to 0.04%	-	-	-	-	-
0.04 to 0.07%	-	-	-	-	-
0.07 to 0.31%	4.7	0.2	-	2.0	6.9
0.31 to 1.00%	64.4	9.5	-	32.2	106.1
1.00 to 3.00%	139.0	16.0	-	82.0	237.0
3.00 to 15.32%	21.1	2.3	-	28.4	51.8
15.32 to 99.99%	1.8	3.9	-	15.5	21.2
100.0%	9.4	1.5	20.0	75.6	106.5
Gross exposure	**240.4**	**33.4**	**20.0**	**235.7**	**529.5**
Less: allowance for losses	(0.6)	(0.2)	(1.0)	(3.2)	(5.0)
Net balance	**239.8**	**33.2**	**19.0**	**232.5**	**524.5**

Unaudited – IAS 39

2017	Retail secured	Optimum	Total
Low–to-medium risk	13,594.0	370.7	13,964.7
Medium–to-high risk	373. 5	113.6	487.1
Total non-impaired drawn balance	13,967.5	484.3	14,451.8

All PDs are calculated using the Internal Ratings Based (IRB) approach under CRD IV. The table is now presented on an IFRS 9 basis, therefore comparison between the years is more limited. For 2017, low-to-medium risk is defined as exposures with a probability of default (PD) in the next year of 1% or below. Medium-to-high risk is defined as exposures with a PD in the next year of greater than 1%. The tables highlight the low-risk nature of the retail secured. Optimum has a higher risk mix, but has a relatively low balance.

The modelling of credit risk impairment is subject to a number of sensitivities including:
- change in the indexed collateral value;
- change in the forced sale discount applied; and
- assumptions around discount rate and the period.

Changes to the above parameters can have a significant impact on the impairment provision.

Forbearance

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

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

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

Unaudited – IFRS 9

	Retail secured					
2018	**Stage 1**	**Stage 2**	**Stage 3**	**POCI**	**Total**	**Allowance for losses**
Concessions	1.1	3.3	0.6	0.3	**5.3**	-
Arrangements	3.7	5.8	7.1	3.2	**19.8**	0.3
Term extensions	-	-	-	-	**-**	-
Assisted voluntary sale	-	-	-	-	**-**	-
Interest only switches	0.9	0.3	-	0.1	**1.3**	-
Capitalisations	-	-	0.1	-	**0.1**	-
Term expired	0.3	0.2	41.9	0.4	**42.8**	1.8
Payment holiday	0.8	4.6	-	-	**5.4**	0.1
Deceased grace period	1.0	0.2	2.4	-	**3.6**	-
	7.8	**14.4**	**52.1**	**4.0**	**78.3**	**2.2**

	Optimum					
2018	**Stage 1**	**Stage 2**	**Stage 3**	**POCI**	**Total**	**Allowance for losses**
Concessions	-	-	0.1	1.2	**1.3**	-
Arrangements	1.1	0.9	2.0	16.1	**20.1**	0.9
Term extensions	-	-	-	-	**-**	-
Assisted voluntary sale	-	-	-	-	**-**	-
Interest only switches	-	-	0.1	-	**0.1**	-
Capitalisations	-	-	-	-	**-**	-
Term expired	1.2	-	12.4	14.4	**28.0**	1.8
Payment holiday	-	0.2	-	0.2	**0.4**	-
Deceased grace period	-	-	0.1	0.4	**0.5**	-
	2.3	**1.1**	**14.7**	**32.3**	**50.4**	**2.7**

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2017	Retail secured Non arrears	In arrears or defaulted	Total	Allowance for losses
Concessions	2.5	3.2	5.7	-
Arrangements	6.9	12.1	19.0	0.1
Term extensions	0.3	0.2	0.5	-
Assisted voluntary sale	-	-	-	-
Interest only switches	1.7	-	1.7	-
Capitalisations	-	-	-	-
Term-expired	48.4	3.1	51.5	0.1
Payment holiday	6.8	0.8	7.6	-
Deceased grace period	1.1	1.3	2.4	0.1
	67.7	20.7	88.4	0.3

2017	Optimum Non arrears	In arrears or defaulted	Total	Allowance for losses
Concessions	0.1	1.3	1.4	-
Arrangements	6.0	25.5	31.5	1.9
Term extensions	-	-	-	-
Assisted voluntary sale	-	-	-	-
Interest only switches	-	-	-	-
Capitalisations	-	-	-	-
Term-expired	33.2	3.8	37.0	0.5
Payment holiday	0.2	-	0.2	-
Deceased grace period	0.1	0.6	0.7	-
	39.6	31.2	70.8	2.4

Overall, the retail secured book has seen a small decline in the value of forbearance cases, mainly in the term-expired category. However, the term expired loss provision has increased by £1.7m. Optimum has seen a decrease in the forbearance values, mainly in term expired and arrangements. However, the allowance for losses has remained broadly similar for Optimum.

3.2.1.2 Unsecured retail credit risk

The unsecured book comprises balances for personal loans, Professional and Career Development Loans (PCDL), credit cards and overdrafts.

Unless otherwise stated, all analysis is based on gross customer balances (for drawn balances) or gross customer balances plus credit commitments (for exposure balances).

Acquisition and account management

The Bank's unsecured lending portfolio comprises of loans, credit cards and overdrafts, although new loans ceased to be offered in April 2018 (the PCDL loan book became closed to new applicants in early 2019). Customers' applications for credit are assessed using a combination of credit scoring and policy rules. Credit cards and overdrafts are subject to ongoing account management to determine any increase or decrease in credit limit that should apply as well as to manage over limit authorisations.

The portfolio risk is reassessed monthly using behavioural scorecards to determine the amount of capital required to be held for individual exposures.

Portfolio analysis

The following table shows unsecured lending gross customer balances (including undrawn commitments) by product type:

Unaudited

	Gross customer balance		**Gross customer exposure**	
	2018	2017	**2018**	2017
Loans	64.6	130.6	64.6	132.5
Professional and career development loans	60.7	66.1	60.7	66.1
Credit cards	322.7	353.9	1,428.8	1,569.7
Overdrafts	28.0	32.7	231.5	252.6
	476.0	583.3	**1,785.6**	2,020.9

Total unsecured balances, including undrawn commitments have decreased by 11.6% during the period. Loan balances have reduced by 51.2% due to asset amortisation and the cessation of new business during 2018. Credit card exposure has reduced by 9.0% driven primarily by customer limit management strategies along with a reduction in customer balances.

Impairment

a) **2018 - IFRS 9**

The Bank assesses the ECL on a forward-looking basis for debt instruments carried at amortised cost and FVOCI and for exposures related to loan commitments and for financial guarantee contracts. The Bank applies the three-stage approach for IFRS 9 to model ECL. See note 1 to the financial statements for the recognition criteria applicable to each of the three stages.

b) 2017 - IAS 39

An impairment provision is recognised for the following categories:

- identified impairment - one day or more past due, forborne or in default (over six months past due, bankruptcy or charged-off); and
- unidentified impairment - on the performing book, based on the probability of the emergence of delinquencies, the probability of default and the discounted cash flow of recoveries from default.

The table below shows the movements in the gross carrying amount (maximum exposure to credit risk including credit commitments) and expected credit loss allowance during the year:

Audited – IFRS 9

Retail unsecured – non-credit impaired	**Stage 1**		**Stage 2**		**Total**	
2018	**Gross customer exposure**	**Allowance for losses**	**Gross customer exposure**	**Allowance for losses**	**Gross customer exposure**	**Allowance for losses**
At the beginning of the year adjusted for IFRS 9	**1,861.4**	**1.1**	**110.6**	**3.1**	**1,972.0**	**4.2**
Changes in assets which transitioned during the year:[1]						
To lifetime ECL	(36.5)	(0.1)	27.7	1.0	**(8.8)**	**0.9**
To credit impaired	(4.8)	-	(3.0)	(0.2)	**(7.8)**	**(0.2)**
To 12 month ECL	55.7	0.2	(59.4)	(1.0)	**(3.7)**	**(0.8)**
From credit impaired	1.8	-	1.3	0.2	**3.1**	**0.2**
Net changes in assets which transitioned during the year:	**16.2**	**0.1**	**(33.4)**	**-**	**(17.2)**	**0.1**
Other charge/(releases):						
New assets originated or purchased	107.0	0.1	-	-	**107.0**	**0.1**
Other changes to risk parameters [2]	(299.6)	2.1	13.2	1.8	**(286.4)**	**3.9**
	(192.6)	**2.2**	**13.2**	**1.8**	**(179.4)**	**4.0**
Assets written off	(3.3)	(2.0)	(3.9)	(2.1)	**(7.2)**	**(4.1)**
At the end of the year	**1,681.7**	**1.4**	**86.5**	**2.8**	**1,768.2**	**4.2**

Retail unsecured – credit impaired	**Stage 3**		**POCI**		**Total**	
2018	**Gross customer exposure**	**Allowance for losses**	**Gross customer exposure**	**Allowance for losses**	**Gross customer exposure**	**Allowance for losses**
At the beginning of the year adjusted for IFRS 9	**43.0**	**23.3**	**5.9**	**0.1**	**48.9**	**23.4**
Changes in assets which transitioned during the year:[1]						
To lifetime ECL	-	-	-	-	**-**	**-**
To credit impaired	5.8	4.1	-	-	**5.8**	**4.1**
To 12 month ECL	-	-	-	-	**-**	**-**
From credit impaired	(4.8)	(1.7)	-	-	**(4.8)**	**(1.7)**
Net changes in assets which transitioned during the year:	**1.0**	**2.4**	**-**	**-**	**1.0**	**2.4**
Other charge/(releases):						
New assets originated or purchased	-	-	-	-	**-**	**-**
Other changes to risk parameters [2]	(2.3)	-	(0.7)	0.1	**(3.0)**	**0.1**
	(2.3)	**-**	**(0.7)**	**0.1**	**(3.0)**	**0.1**
Assets written off	(29.4)	(17.6)	(0.1)	-	**(29.5)**	**(17.6)**
At the end of the year	**12.3**	**8.1**	**5.1**	**0.2**	**17.4**	**8.3**

Retail unsecured – total	Total	
2018	**Gross customer exposure**	**Allowance for losses**
At the beginning of the period adjusted for IFRS 9	**2,020.9**	**27.6**
Changes in assets which transitioned during the year:[1]		
To lifetime ECL	(8.8)	0.9
To credit impaired	(2.0)	3.9
To 12 month ECL	(3.7)	(0.8)
From credit impaired	(1.7)	(1.5)
Net changes in assets which transitioned during the year:	**(16.2)**	**2.5**
Other charge/(releases):		
New assets originated or purchased	107.0	0.1
Other changes to risk parameters[2]	(289.4)	4.0
	(182.4)	4.1
Assets written off	(36.7)	(21.7)
At the end of the year	**1,785.6**	**12.5**

1. Includes the impact of both transition and repayments on assets which transitioned during the year.
2. Includes repayments (other than those related to assets which transitioned during the year) and changes due to other model inputs.

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	2017
Impaired balance at start of year	71.4
Classified as impaired during the year	15.0
Transferred to not impaired during the year	(6.7)
Bulk debt sale during the year	(19.9)
Other write off during the year	(15.5)
Other repayments during the year	(1.2)
Impaired balance at end of year	43.1

Retail unsecured exposures have declined by £0.2bn as a result of the ceasing of new loan business alongside the regular repayment of debt and a debt sale programme. The ECL has decreased by £15.1m mainly as a result of write offs (£36.7m exposure and £21.7m ECL) mainly offset by an increase of £2.5m in the stage transfer, mainly due to a movement of cases into stage 3.

There has been minimal impact due to the macroeconomic scenarios and no changes to the model.

The basis of calculation of the reconciliation of opening and closing balances and the allowance for loan losses is calculated in the sequential order in the table above. The calculation of the reconciliation of transfers between stages is performed by comparing 1 January 2018 opening values compared to closing 31 December 2018 month-end values; which includes the impact of repayments. New assets originated or purchased in the table above, include loan commitments. Changes to risk parameters (model inputs) in the table above, includes repayments (excluding those in transfers) plus other model-related movements. Assets de-recognised disclosed in the table above, only includes write offs.

Modelling of credit risk impairment is subject to a number of sensitivities as set out in note 2. Changes to the above parameters can have a significant impact on the impairment provision.

Retail unsecured products are all subject to an allowance being calculated and allocated under the ECL models. None are excluded on the basis of low LTV.

The write off for retail unsecured was £36.7m. At the point of write off the Bank has no further pro-active debt recovery activity as recovery of the outstanding balance is deemed unlikely, uneconomical or inappropriate.

Ratios – impaired assets and allowance for losses

The following table shows the impaired and coverage ratios. Note that the ratios are based on the balance sheet values (including other accounting adjustments):

Audited

Unsecured retail	2018					2017
	Stage 1	Stage 2	Stage 3	POCI	Total	Total
Gross loans and advances to customers	**409.0**	**65.8**	**11.5**	**2.8**	**489.1**	592.3
of which impaired	**-**	**-**	**11.5**	**2.8**	**14.3**	43.1
Impaired as a % of gross loans and advances to customers	**0.0%**	**0.0%**	**100.0%**	**100.0%**	**2.9%**	7.3%
Allowance for losses	**1.4**	**2.8**	**8.1**	**0.2**	**12.5**	30.6
Coverage - impaired assets	**N/a**	**N/a**	**70.4%**	**7.1%**	**58.0%**	71.0%
Coverage - total book	**0.34%**	**4.26%**	**70.43%**	**7.14%**	**2.56%**	5.17%

A decrease of £103.2m ((17) %) in gross loans and advances in 2018 is driven by lower personal balances following the cessation of new loan business alongside regular repayments and debt sales. The proportion of impaired loans has reduced from 7.3% to 2.9% driven largely by the programme of debt sales and as a result, provision coverage has halved to 2.6% from 5.2%.

Risk grade

The table below analyses the credit risk exposure for retail unsecured for which ECL is recognised. The gross carrying amount also represents the Bank's maximum exposure to credit risk on these assets:

Unaudited – IFRS 9

2018[1]	Retail unsecured				
Credit grade	**Stage 1**	**Stage 2**	**Stage 3**	**POCI**	**Total**
0.00 to 0.04%	120.5	24.7	-	-	**145.2**
0.04 to 0.07%	-	-	-	-	**-**
0.07 to 0.12%	501.3	0.2	-	-	**501.5**
0.12 to 0.31%	363.8	1.8	-	0.5	**366.1**
0.31 to 0.50%	343.5	3.3	-	0.9	**347.7**
0.50 to 1.00%	69.1	2.9	-	-	**72.0**
1.00 to 5.00%	248.3	31.6	-	3.2	**283.1**
5.00 to 10.00%	28.6	17.6	-	0.4	**46.6**
10.00 to 20.00%	4.2	1.1	-	-	**5.3**
20.00 to 50.00%	2.1	2.3	-	-	**4.4**
50.00 to 99.99%	0.2	0.5	-	-	**0.7**
100.00%	0.1	0.5	12.3	0.1	**13.0**
Gross balance	**1,681.7**	**86.5**	**12.3**	**5.1**	**1,785.6**
Less: allowance for losses	(1.4)	(2.8)	(8.1)	(0.2)	**(12.5)**
Net balance	**1,680.3**	**83.7**	**4.2**	**4.9**	**1,773.1**

1. Comparative credit grading information is not required for first year adoption of IFRS 9 as set out in IFRS 7.

All PDs are calculated using the IRB approach under CRD IV.

3.2.1.3 Corporate credit risk

In prior years the corporate book has been managed in two parts: Business and Commercial Banking (BaCB) and legacy. The legacy portfolio of the book has seen active de-leveraging over the last few years as these assets were not compatible with the strategy and risk appetite of the Bank. As a result, the portfolio has significantly reduced, alongside the risk profile of the book. The BaCB element focused on lending to small businesses, charities and existing customers. The book is now being reported as a combined portfolio, with less active de-leveraging.

The table below shows the exposure of the corporate book analysed by sector. The book mainly comprises low-risk Housing Association and PFI portfolios. Unless otherwise stated, all analysis is based on gross customer balances (for drawn balances) or gross customer balances plus credit commitments (for exposure balances):

2018	**Strong**	**Good**	**Satisfactory**	**Weak**	**Standardised**	**Default**	**Total**	**Asset split**
Business Banking	17.6	11.7	10.5	3.9	0.1	0.3	**44.1**	3.1%
Commercial Real Estate	2.5	116.2	13.9	1.5	1.6	28.4	**164.1**	11.7%
Renewable Energy	-	-	-	-	32.2	-	**32.2**	2.3%
Retail/Wholesale	11.3	62.0	0.1	-	0.2	-	**73.6**	5.2%
Education	-	0.6	-	-	41.7	-	**42.3**	3.0%
Financial/Legal/Accounting	0.6	8.1	0.9	-	5.8	0.2	**15.6**	1.1%
Care	0.6	1.0	0.2	-	0.6	-	**2.4**	0.2%
Food/Hotel/Leisure	2.5	10.1	6.4	-	2.5	-	**21.5**	1.5%
Housing Associations	366.3	-	-	-	1.0	-	**367.3**	26.1%
PFI	552.6	9.8	-	14.4	-	-	**576.8**	40.9%
Charities	-	1.9	-	-	12.5	-	**14.4**	1.0%
Other	15.8	6.5	1.5	4.5	16.5	10.2	**55.0**	3.9%
	969.8	**227.9**	**33.5**	**24.3**	**114.7**	**39.1**	**1,409.3**	**100.0%**

2017[1]	Strong	Good	Satisfactory	Weak	Standardised	Default	Total	Asset split
Business Banking	15.3	12.3	10.4	2.8	0.3	0.2	41.3	2.4%
Commercial Real Estate	1.9	174.2	4.9	8.3	16.8	43.6	249.7	14.6%
Renewable Energy	-	-	-	-	43.5	-	43.5	2.5%
Retail/Wholesale	16.4	61.1	0.1	0.3	0.3	-	78.2	4.6%
Education	-	0.2	-	-	52.2	-	52.4	3.0%
Financial/Legal/Accounting	0.6	10.3	0.9	0.3	10.9	0.2	23.2	1.4%
Care	4.9	0.6	0.6	2.7	1.4	-	10.2	0.6%
Food/Hotel/Leisure	10.6	14.1	7.0	5.9	5.2	-	42.8	2.5%
Housing Associations	443.5	-	-	-	1.3	-	444.8	25.9%
PFI	607.7	9.8	-	15.3	-	-	632.8	36.9%
Charities	-	3.7	-	-	18.8	-	22.5	1.3%
Other	8.7	9.2	3.0	1.6	33.5	18.0	74.0	4.3%
	1,109.6	295.5	26.9	37.2	184.2	62.0	1,715.4	100.0%

1. 2017 has been re-presented to show a combined corporate book (previously Legacy and BaCB) and latest analysis by lending types as reported to CROC. The analysis of the rating categories has also been re-presented to the latest grade definition.

Further analysis of the corporate book can be seen in the Pillar 3 disclosures.

Acquisition and account management
The lending criteria requires borrowers to meet criteria as laid down in individual sector strategy guidelines and operates a strict policy with regards to single name concentrations.

Collateral
Various forms of collateral are used, including guarantees, to mitigate credit risk. Property collateral for corporate lending is categorised as security for property development/investment customers (i.e. commercial real estate) or owner occupied premises to secure mainstream loan and overdraft facilities. For general lending, in addition to taking charges over property assets owned by the customer, other security is taken in modest proportion to the total portfolio. This includes debentures or floating charges, cash cover and guarantees (often supported by tangible security where appropriate, including property, life policies and stocks and shares).

Property valuations are obtained when the facility is first approved and our lending procedures typically require collateral to be revalued every three years, or more frequently in higher risk situations (typically annually or when a material change has occurred that is likely to affect the value and/or recoverability of the debt). In certain circumstances, such as syndicates, the multi-bank facility letter may preclude revaluations at the customer's expense, of all the assets as frequently as this and a decision is required by all banks involved, to decide if they require the updates more frequently.

The policies for obtaining collateral have not significantly changed during the year. There has been no significant change in the overall quality of the collateral held during the year.

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

Audited – IFRS 9

2018	Stage 1			Stage 2		
Corporate - non-impaired loans with <1 year until refinancing						
	Exposure	**Collateral[1]**	**Allowance for losses**	**Exposure**	**Collateral[1]**	**Allowance for losses**
≤50% LTV	15.6	15.6	-	2.7	2.7	-
>50% ≤80% LTV	4.8	4.8	-	3.4	3.4	-
>80% ≤100% LTV	-	-	-	-	-	-
>100% LTV	-	-	-	-	-	-
Not secured by property	2.4	-	-	-	-	-
	22.8	**20.4**	**-**	**6.1**	**6.1**	**-**
Corporate - non-impaired loans with >1 year until refinancing						
≤50% LTV	147.5	147.5	0.1	10.3	10.3	-
>50% ≤80% LTV	343.5	343.5	0.2	7.8	7.8	-
>80% ≤100% LTV	26.2	26.2	-	-	-	-
>100% LTV	66.7	29.6	0.1	0.5	0.1	-
Not secured by property	593.3	-	1.7	24.2	-	0.6
	1,177.2	**546.8**	**2.1**	**42.8**	**18.2**	**0.6**
	1,200.0	**567.2**	**2.1**	**48.9**	**24.3**	**0.6**

2018	Stage 3			POCI		
Corporate – all impaired loans						
	Exposure	**Collateral[1]**	**Allowance for losses**	**Exposure**	**Collateral[1]**	**Allowance for losses**
≤50% LTV	0.4	0.4	-	-	-	-
>50% ≤80% LTV	0.8	0.8	-	-	-	-
>80% ≤100% LTV	-	-	-	-	-	-
>100% LTV	30.2	22.8	13.1	-	-	-
Not secured by property	6.4	-	5.8	1.3	-	1.3
	37.8	**24.0**	**18.9**	**1.3**	**-**	**1.3**

2018	Total		
Corporate – total loans - impaired and non-impaired with <1 year until refinancing			
	Exposure	**Collateral[1]**	**Allowance for losses**
≤50% LTV	18.7	18.7	**-**
>50% ≤80% LTV	9.0	9.0	**-**
>80% ≤100% LTV	-	-	**-**
>100% LTV	30.2	22.8	**13.1**
Not secured by property	10.1	-	**7.1**
	68.0	50.5	**20.2**
Corporate – total loans - non-impaired with >1 year until refinancing			
≤50% LTV	157.8	157.8	**0.1**
>50% ≤80% LTV	351.3	351.3	**0.2**
>80% ≤100% LTV	26.2	26.2	**-**
>100% LTV	67.2	29.7	**0.1**
Not secured by property	617.5	-	**2.3**
	1,220.0	**565.0**	**2.7**
	1,288.0	**615.5**	**22.9**

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Corporate	2017 Exposure	Collateral[1]	Allowance for losses
Non-default loans with <1 year until refinancing and all defaulted regardless of term			
≤50% LTV	13.5	13.4	-
>50% ≤80% LTV	46.2	44.3	1.8
>80% ≤ 100% LTV	1.6	1.2	0.3
>100% LTV	38.8	19.3	19.0
Unsecured	26.9	-	8.6
	127.0	78.2	29.7
Non-default loans with >1 year until refinancing			
≤50% LTV	284.1	284.1	-
>50% ≤80% LTV	418.6	418.6	-
>80% ≤ 100% LTV	99.2	99.2	-
>100% LTV	70.0	31.9	-
Unsecured	716.5	-	1.2
	1,588.4	833.8	1.2
	1,715.4	912.0	30.9

1. Collateral is constrained to a maximum of 100% of the exposure to each customer to correctly reflect the maximum protection available to the Bank. For the purposes of determining capital and impairment appropriate forced sale discounts are applied to collateral. As at 31 December 2018 £0.8m (2017: £1.7m) of the collateral is not held as a first charge.

Impairment
a) 2018 – IFRS 9

Expected credit loss (ECL) is assessed on a forward-looking basis for debt instruments carried at amortised cost and FVOCI, and for exposures related to loan commitments, and financial guarantee contracts. The IFRS 9 three-stage approach is used to model ECL. See note 1 to the financial statements for the recognition criteria applicable to each of the three stages.

Watchlist accounts are considered as being at risk and require close control, but not sufficiently so as to warrant transitioning to stage 3. There are a number of triggers, which when met, will result in the customer being classed as watchlist. These triggers include being 30 days past due, cash flow pressures, failure to pay interest when it falls due, potential insolvency event, unsatisfactory account operation or other signs of financial distress.

Movements in the gross carrying amount (maximum exposure to credit risk including credit commitments) and expected credit loss allowance during the year are shown in the following table:

Audited – IFRS 9

Corporate – non-credit impaired	**Stage 1**		**Stage 2**		**Total**	
2018	**Gross customer exposure**	**Allowance for losses**	**Gross customer exposure**	**Allowance for losses**	**Gross customer exposure**	**Allowance for losses**
At the beginning of the period adjusted for IFRS 9	**1,445.8**	**3.3**	**65.8**	**1.5**	**1,511.6**	**4.8**
Changes in assets which transitioned during the year:[1]						
To lifetime ECL	(11.4)	-	10.9	-	**(0.5)**	**-**
To credit impaired	(0.1)	-	(0.1)	-	**(0.2)**	**-**
To 12 month ECL	7.2	-	(7.9)	(0.2)	**(0.7)**	**(0.2)**
From credit impaired	-	-	2.7	-	**2.7**	**-**
Net changes in assets which transitioned during the year:	**(4.3)**	**-**	**5.6**	**(0.2)**	**1.3**	**(0.2)**
Other charge/(releases) :						
New assets originated or purchased	20.5	-	-	-	**20.5**	**-**
Other changes to risk parameters [2]	(261.8)	(1.0)	(21.7)	(0.6)	**(283.5)**	**(1.6)**
	(241.3)	**(1.0)**	**(21.7)**	**(0.6)**	**(263.0)**	**(1.6)**
Assets written off	(0.2)	(0.2)	(0.8)	(0.1)	**(1.0)**	**(0.3)**
As at 31 December 2018	**1,200.0**	**2.1**	**48.9**	**0.6**	**1,248.9**	**2.7**

Corporate – credit impaired	Stage 3		POCI		Total	
2018	Gross customer exposure	Allowance for losses	Gross customer exposure	Allowance for losses	Gross customer exposure	Allowance for losses
At the beginning of the period adjusted for IFRS 9	**60.7**	**27.7**	**1.3**	**1.3**	**62.0**	**29.0**
Changes in assets which transitioned during the year:[1]						
To lifetime ECL	-	-	-	-	**-**	**-**
To credit impaired	0.2	0.1	-	-	**0.2**	**0.1**
To 12 month ECL	-	-	-	-	**-**	**-**
From credit impaired	(3.1)	(0.3)	-	-	**(3.1)**	**(0.3)**
Net changes in assets which transitioned during the year:	**(2.9)**	**(0.2)**	**-**	**-**	**(2.9)**	**(0.2)**
Other charge/(releases):						
New assets originated or purchased	-	-	-	-	**-**	**-**
Other changes to risk parameters [2]	(15.7)	(6.1)	-	-	**(15.7)**	**(6.1)**
	(15.7)	**(6.1)**	**-**	**-**	**(15.7)**	**(6.1)**
Assets written off	(4.3)	(2.5)	-	-	**(4.3)**	**(2.5)**
At the end of the year	**37.8**	**18.9**	**1.3**	**1.3**	**39.1**	**20.2**

Corporate – total	Total	
2018	Gross customer exposure	Allowance for losses
At the beginning of the period adjusted for IFRS 9	**1,573.6**	**33.8**
Changes in assets which transitioned during the year:[1]		
To lifetime ECL	**(0.5)**	**-**
To credit impaired	**-**	**0.1**
To 12 month ECL	**(0.7)**	**(0.2)**
From credit impaired	**(0.4)**	**(0.3)**
Net changes in assets which transitioned during the year:	**(1.6)**	**(0.4)**
Other Charge/(Releases):		
New assets originated or purchased	**20.5**	**-**
Other changes to risk parameters[2]	**(299.2)**	**(7.7)**
	(278.7)	**(7.7)**
Assets written off	**(5.3)**	**(2.8)**
At the end of the year	**1,288.0**	**22.9**

1. Includes the impact of both transition and repayments on assets which transitioned during the year.
2. Includes repayments (other than those related to assets which transitioned during the year) and changes due to other model inputs.

The corporate book has continued to reduce in size as it is mainly a closed book with limited appetite for new lending. The continued repayment of debt has seen the overall ECL reduce by £10.9m alongside a £0.3bn reduction in gross exposure. The main element is the decline in the book size and updated revaluations resulting in a £7.7m decrease in ECL with the other main reduction being the write off of opening balances of £5.3m which has reduced the ECL by £2.8m.

The basis of calculation of the reconciliation of opening and closing balances and the allowance for loan losses is calculated in the sequential order in the table above. The calculation of the reconciliation of transfers between stages is performed by comparing 1 January 2018 opening values compared to closing 31 December 2018 month-end values; which includes the impact of repayments. New assets originated or purchased in the table above, include loan commitments. Changes to risk parameters (model inputs) in the table above, includes repayments (excluding those in transfers) plus other model-related movements. Assets de-recognised disclosed in the table above only includes write offs.

There has been minimal impact due to the macroeconomic scenarios and no changes to the model.

The write off for corporate was £5.3m. Corporate write off occurs when the Bank expects no further recoveries and all recovery activity has been explored and exhausted.

c) 2017 – IAS 39

Audited

Corporate	2017
Impaired balance at start of year	165.6
Classified as impaired during the year	44.9
Transferred to non-impaired during year	(23.6)
Amounts written off	(15.1)
Net repayments and other	(63.1)
Impaired balance at the end of the year	108.7

Corporate loans have three distinct categories for management. These are live; watchlist; and default. Impaired assets comprise watchlist and default accounts. Past due and impaired exposures are monitored via a watchlist status that contains specific triggers that, when met, result in the customer being added to a watchlist. These triggers include cash flow pressures, failure to pay interest when it falls due, potential insolvency event and unsatisfactory account operation. Watchlist accounts are considered as being at risk and require close control, but not sufficiently so to warrant the raising of specific bad and doubtful debt provision or meeting the regulatory definition of default.

After a period of satisfactory performance, customers may be removed from watchlist status. Prior to removal, satisfaction must be obtained that the relevant trigger events no longer apply. The decision to remove an account from watchlist status should be supported by appropriate management information at the point of removal depending upon the nature of the initial triggers.

Ratios – impaired assets and allowance for losses

The following table shows the impaired and coverage ratios. Note that the ratios are based on the balance sheet values (including other accounting adjustments):

Audited

Corporate	**2018**					2017
	Stage 1/FVTPL	**Stage 2**	**Stage 3**	**POCI**	**Total**	Total
Gross loans and advances to customers[1]	1,117.3	47.5	37.5	1.3	**1,203.6**	1,478.7
of which impaired	-	-	37.5	1.3	**38.8**	108.7
Impaired as a % of gross loans and advances to customers	0.0%	0.0%	100.0%	100.0%	**3.2%**	7.4%
Allowance for losses	2.1	0.6	18.9	1.3	**22.9**	30.9
Coverage - impaired assets	**N/a**	**N/a**	**50.4%**	**100.0%**	**59.0%**	28.4%
Coverage - total book	**0.19%**	**1.27%**	**50.40%**	**100.00%**	**1.90%**	2.09%

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

As the above table is now compiled on an IFRS 9 basis (as opposed to IAS 39 in 2017) direct comparison is more difficult. The impaired ratio has reduced; however, under IFRS 9 all watchlist cases are now not classified as impaired, which has contributed to the reduction. However, overall the corporate balance has continued to decline alongside a lower ECL which has resulted in the total coverage reducing from 2.09% to 1.90%.

Risk grade

The table below analyses the credit risk exposure for corporate for which ECL is recognised. The gross carrying amount also represents the Bank's maximum exposure to credit risk on these assets:

2018[1]

Corporate credit grade	**Stage 1**	**Stage 2**	**Stage 3**	**POCI**	**Total**
Standardised	90.4	4.5	-	-	**94.9**
Strong	867.9	0.4	-	-	**868.3**
Good	217.3	10.6	-	-	**227.9**
Satisfactory	21.0	12.5	-	-	**33.5**
Weak	3.4	20.9	-	-	**24.3**
Default	-	-	37.8	1.3	**39.1**
Gross balance	**1,200.0**	**48.9**	**37.8**	**1.3**	**1,288.0**
Loss allowance	(2.1)	(0.6)	(18.9)	(1.3)	**(22.9)**
Net balance	**1,197.9**	**48.3**	**18.9**	**-**	**1,265.1**

1. Comparative credit grading information is not required for first year adoption of IFRS 9 as set out in IFRS 7

Forbearance

The identification of financial difficulty is a key part of the process of deploying forbearance. The Bank's practices and accounting policies in relation to forborne assets are detailed in note 1 to the financial statements. Forborne concessions that are considered include:

- a partial write off of debt, following which the account continues to be classified as impaired for at least twelve months; or
- a material postponement or forgiveness of interest or waiver or reduction of normal fees and charges; the account must remain impaired while such favourable terms are being applied.

The table below analyses the gross carrying amount (maximum exposure to credit risk including credit commitments) subject to forbearance:

Unaudited – IFRS 9

Corporate **2018**	**Forborne**	**Non-forborne**	**Total**
Stage 1			
Exposure	-	1,200.0	**1,200.0**
Collateral	-	567.2	**567.2**
Allowance for losses	-	2.1	**2.1**
Stage 2			
Exposure	19.9	29.0	**48.9**
Collateral	4.2	20.1	**24.3**
Allowance for losses	0.6	-	**0.6**
Stage 3			
Exposure	11.3	26.5	**37.8**
Collateral	9.4	14.6	**24.0**
Allowance for losses	6.8	12.1	**18.9**
POCI			
Exposure	-	1.3	**1.3**
Collateral	-	-	**-**
Allowance for losses	-	1.3	**1.3**
Total			
Exposure	**31.2**	**1,256.8**	**1,288.0**
Collateral	**13.6**	**601.9**	**615.5**
Allowance for losses	**7.4**	**15.5**	**22.9**

For those customers that benefit from ongoing concessions (such as postponement of principal payments), the forbearance status is retained for as long as the concession remains in place. In the event of one off concessions (such as capitalisation of interest payments), the forbearance status is required to be removed 12 months after the occurrence, provided that the loan has been kept up to date during that period and all covenants continue to be met.

2017 – IAS 39

Forbearance concessions are considered to be objective evidence of impairment and include:

- a partial write off of debt, following which, the account continues to be classified as impaired for at least six months; or
- a material postponement or forgiveness of interest, or waiver or reduction of normal fees and charges; the accounts must remain impaired while such favourable terms are being applied.

The table below analyses the exposures subject to forbearance:

Unaudited – IAS 39

2017 – Restated[1] Corporate	Forborne	Non-forborne	Total
Default	11.4	50.7	62.1
On watch list	28.5	20.0	48.5
Neither default nor on watchlist [2]	0.9	1,603.9	1,604.8
	40.8	1,674.6	1,715.4

1. The 2017 corporate forbearance has been restated to the forbearance definition used for 2018.
2. The forborne exposure not classed as default or on watchlist are business banking accounts.

3.2.2 Investment securities credit risk

No allowance for losses has been recognised for investment securities in either 2018 or 2017. All are classified as low-to-medium risk. The Bank has applied the low credit risk exemption available within IFRS 9 to treasury assets with an external rating of investment grade. For further information see note 15 to the consolidated financial statements.

2018	Investment securities			
Analysis of balance in note 15	**Amortised cost**	**FVOCI**	**FVTPL**	**Total**
Gross balance				
Stage 1	89.1	1,842.4	-	**1,931.5**
Stage 2	-	-	-	**-**
Stage 3 / POCI1	-	-	-	**-**
Fair value through profit or loss	-	-	3.5	**3.5**
Total gross balance	**89.1**	**1,842.4**	**3.5**	**1,935.0**
Less: allowance for losses	-	-	-	**-**
Net credit risk exposure	**89.1**	**1,842.4**	**3.5**	**1,935.0**

1. There are currently no POCI investment securities.

Credit risk mitigation

There are policies in place with regard to the management and valuation of collateral which are used as a form of credit risk mitigation. Only cash deposits, UK government bonds or other debt securities issued by a central government or qualifying multi-lateral development bank with a minimum rating of AA are accepted as collateral. It is also a requirement of the Treasury Credit Risk Policy that all securities received as collateral are valued on a daily basis and collateral calls made in line with the relevant legal agreement.

Impaired assets

a) 2018 – IFRS 9

ECL is assessed on a forward-looking basis for debt instruments carried at amortised cost and FVOCI. The IFRS 9 three-stage approach is applied to calculate ECL. See note 1 to the financial statements for the recognition criteria applicable to each of the three stages.

b) 2017- IAS 39

Investment securities are considered past due when the contractual interest or principal payments are in arrears, and it is determined that all principal and interest outstanding will be collected according to the contractual terms of the agreements. Investment securities are considered impaired where it is determined all principal and interest outstanding will not be collected, according to the contractual terms of the agreements.

At the balance sheet date, investment securities were reassessed for objective evidence that an impairment loss has occurred. Particular consideration was given to evidence of any significant difficulty of the issuer or measurable decrease in the estimated cash flows from the investments.

Only investments in treasury assets which have a rating from an external credit rating agency equivalent to a rating by Fitch Rating Services of A or above are made.

3.2.3 Loans and advances to banks

No allowance for losses has been recognised for loans and advances to banks in either 2018 or 2017. These exposures are currently considered to all be of low-to-medium risk and the ECL has been deemed to be immaterial. ECL is assessed on a forward-looking basis for debt instruments carried at amortised cost and FVOCI. The IFRS 9 three-stage approach is applied to calculate ECL. See note 1 to the financial statements for the recognition criteria applicable to each of the three stages.

3.2.4 Derivative financial instruments

During 2018, all new derivative transactions continued to be cleared through a central clearing counterparty and agreement has been sought from a number of counterparties to re-book existing derivative transactions through a central clearing counterparty. In accordance with IFRS 13, a credit value adjustment (CVA) of £0.6m was recorded (31 December 2017: £0.7m) in relation to non-collateralised swaps; the reduction being mainly due to the reduction in the book size.

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	2018		2017	
	Notional	**Fair value (net)**	Notional	Fair value (net)
Interest rate				
Bi-lateral collateral agreements	**15,233.0**	**(203.0)**	12,291.1	(243.6)
One way collateral[1]	**2,015.2**	**22.9**	2,466.8	28.7
No collateral agreement	**376.9**	**112.0**	417.2	132.2
Foreign exchange				
Bi-lateral collateral agreements	**15.0**	**(0.1)**	25.9	0.2
One way collateral[1]	**-**	**-**	-	-
No collateral agreement	**6.0**	**(0.2)**	6.0	(0.1)
	17,646.1	**(68.4)**	15,207.0	(82.6)

1. The above table separately identifies one way collateral agreements. Further disclosures on derivatives are contained in note 16 to the consolidated financial statements.

3.2.5 Wholesale credit risk

The treasury portfolio is held primarily for liquidity management purposes and, in the case of derivatives, for the purpose of managing market risk. Exposures to the UK Government and the Bank of England account for 66% (2017: 73%) of all treasury exposures. The remaining exposures are split 11% (2017: 13%) to residential mortgage-backed securities, 9% (2017: 8%) to financial institutions and 14% (2017: 6%) non-domestic sovereign and qualifying multi-lateral development bank bonds. No allowance for losses has been recognised in either 2018 or 2017. The IFRS 9 three-stage approach is applied to calculate ECL and the ECL value has been deemed to be immaterial. See note 1 to the financial statements for the recognition criteria applicable to each of the three stages.

3.2.5.1 Direct exposures

Within the treasury portfolio there are a number of risk mitigation techniques available including netting and collateralisation agreements. Other methods such as disposal and credit derivatives are used periodically to mitigate the credit risk associated with particular transactions.

Treasury operates a risk-based approach which monitors counterparty limits and exposure. Both the counterparties and assets held are monitored against a Board-approved matrix of risk tolerance and associated indicators. The scope of this monitoring activity includes rating actions, market events and financial results as they are announced. These factors may influence a change in risk status and possible escalation requiring management actions and inclusion on the watchlist.

The portfolio and watchlist is monitored daily for appropriate risk status bandings and any associated management actions. As at 31 December 2018, there were no red (highest-risk) exposures outstanding (2017: £nil).

During 2018, exposures to financial institutions in European countries were broadly consistent with the year-end, with a total gross exposure outstanding at 31 December 2018 of £92m (2017: £188m). Post credit risk mitigation, the net exposure was £51m (2017: £131m).

3.2.5.2 Indirect exposures

Treasury monitoring extends beyond direct risk incurred through counterparty trading, to the underlying exposures, which the counterparties may maintain on their own balance sheets. In analysing each counterparty's secondary exposure, the vulnerability and impact on that counterparty is assessed should it suffer different degrees of losses.

Where secondary sovereign exposure or contagion risk is deemed to undermine the performance of the counterparty, remedial management actions are taken in respect of the counterparty limits and exposure.

3.2.6 Other assets

An allowance for losses has been recognised for other assets as part of the opening 2018 adjustments under IFRS 9. There is currently a very small provision of under £0.1m at the end of 2018. However, there was no provision in 2017. The exposures are currently considered to be of low risk. ECL is assessed on a forward-looking basis for instruments carried at amortised cost and FVOCI. The IFRS 9 three-stage approach is applied to calculate ECL. See note 1 to the financial statements for the recognition criteria applicable to each of the three stages.

4. MARKET RISK

4.1 Overview – Unaudited

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

The main sources of market risk are: mismatches between the re-pricing profiles of asset and liability customer products; certain characteristics embedded within these products; sovereign swap spread risk; and credit spread risk. Interest rate risk is primarily driven by: the holding of fixed rate assets within its liquidity asset buffer; the sale of fixed rate mortgages and savings products to its customer base; and the degree to which these are hedged using the derivative instruments. Whilst there is no trading book, market risk is created through various portfolio management activities and risk-management strategies employed to reduce earnings volatility.

Given there is no trading book and the net currency positions are below the required threshold, no Pillar 1 market risk requirement exists. All market risk exposures are addressed under the PRA Pillar 2 framework, which is captured as part of the ICG requirement.

The main measure utilised in market risk is PV01, which measures the sensitivity of the Net Present Value (NPV) to a one basis point (bp) parallel shift in interest rates. The PV01 is the daily calculation of the effect on the NPV of assets, liabilities and derivatives to both parallel and specific point of yield curve stress testing (i.e. non-linear yield curve shifts) by one bp. The residual interest rate risk is hedged using predominantly LIBOR-based, but increasingly SONIA (Sterling Overnight Interbank Average rate) based swaps. Where exposures to floating rate indices do not match between floating rate, or hedged to floating rate assets and liabilities, there is also a resultant basis risk. The Bank's response to the future move to SONIA is in the process of being fully formulated.

Market risk exposures have been maintained well within overall risk appetite which has decreased since the end of 2017. Interest rate risk when expressed in terms of PV01, averaged £(26.2)k during 2018 with a low of £(113.0)k and a high of £30.0k. The Bank-wide market risk position was managed to a short asset position ahead of the year end, with total net sensitivity across the Bank's balance sheet managed up to a total PV01 of £12k.

4.2 Primary risk metrics and sources of market risk - Unaudited

The key drivers of market risk faced, and the metrics used to manage those risks are:

Interest rate risk

The primary risk metric employed to manage directional interest rate risk and yield curve risk is the sensitivity of the Bank's NPV to a one bp parallel shift in interest rates (i.e. the PV01). Limits are set at an overall level for directional interest rate risk and against individual time buckets for yield curve risk.

To supplement the gapped and overall PV01 limits noted above, stress testing of exposures against historical yield curve shifts is undertaken on a monthly basis. This assesses the sensitivity to the most extreme curve steepening and curve flattening movements, to a 99% confidence, seen over a one month period during the previous ten years.

A key aspect in the management and measurement of interest rate risk is the modelling of the behaviour of certain elements of the balance sheet. Behavioural assumptions are limited to the treatment of non-interest bearing balances and expectations with regard to customer prepayments within the residential mortgage and unsecured loan portfolios. The current account portfolio is periodically assessed in order to identify a stable, non-interest bearing 'core' element compared to the more volatile, rate sensitive and transitory balances. A behavioural duration is applied to the former, while the latter are assumed to re-price within one month. Other non-maturity deposits are not subject to a behavioural adjustment and are assumed to reprice within one month.

Similar assumptions are made for other non-interest bearing balance sheet items such as non-dated capital, all of which are reviewed and approved by the ALCo.

Risk exposures are formally calculated at least monthly. Interest rate risk and effectiveness of hedging is monitored, at a minimum of weekly, using gap positions, incorporating new business requirements. Drawdown risk, in particular for fixed rate mortgages, is managed through weekly tranche meetings. Interest rate risk is hedged using derivative instruments and investment securities to external wholesale markets.

Basis risk

The definition of basis risk is the risk of loss as a result of the balance sheet being adversely affected by the movement between different index rates.

Basis risk in the balance sheet is mainly driven by a mix of exposures to LIBOR base rate and administered rate. LIBOR exposures are created through the holding of LIBOR linked assets such as RMBS (Residential Mortgage Backed Securities) and as a result of hedging fixed rate retail products and fixed rate sovereign debt. Reserve balances at the Bank of England and tracker mortgages generate a base rate asset with administered rate exposures generated by mortgages and savings products.

Basis risk is managed using an earnings-at-risk based metric, focusing in detail on the sensitivity of changes in interest rates on net interest income over a one-year period. The assumed potential loss of earnings reflects the downside risk comparing the prevailing relevant spreads against their historical extremes. The estimated earnings-at-risk is then expressed as a percentage of the forecasted net interest income over the next 12 months.

Basis risk is monitored monthly by Treasury Market and Credit Risk Working Group (TMCRWG) and ALCo with action taken as required.

Sovereign swap spread risk
Swap spread risk is defined as the sensitivity of the combined economic value of sovereign securities and their associated derivative hedges to changes in the spread between benchmark sovereign bond yields and swap rates. These assets are used for liquidity purposes within the treasury portfolio.

Swap spread risk is managed by calculating on a daily basis, the sensitivity of its hedged fixed rate bond portfolio to a one bp divergence in yields between the fixed rate bond and its hedge (PV01).

Credit spread risk
Credit spread risk is defined as the risk of loss from changes in the credit spread on wholesale assets.

Non-sovereign term exposures relate primarily to holdings of residential mortgage backed securities issued by Warwick Finance One, Warwick Finance Two and Warwick Finance Three, which reflect the retained elements from the deleveraging of the Bank's assets. The potential risk from these holdings is assessed against historical spread movements of similar securitisation transactions. Given that we do not seek to actively transact in this type of asset, each purchase is individually agreed by ALCo and a maximum notional limit set.

Foreign exchange risk
The exposure to foreign exchange risk is primarily limited to customer hedging transactions and incidental customer transactions. Therefore, to manage this risk an overall maximum notional net Sterling position limit is set for overnight exposures. This is supported by applying sub-limits to currencies by tier to reflect their liquidity.

The table below is an analysis of the assets and liabilities by currency in Sterling equivalent terms.

Audited

	2018					2017				
	£	**$**	**€**	**Other**	**Total**	£	$	€	Other	Total
Assets[1]										
Cash and balances at central bank	1,843.8	-	-	-	**1,843.8**	4,032.1	-	-	-	4,032.1
Loans and advances to banks	470.1	11.6	3.7	0.4	**485.8**	549.5	11.4	13.3	0.6	574.8
Loans and advances to customers	17,732.2	1.7	-	-	**17,733.9**	16,741.5	3.0	-	-	16,744.5
Fair value adjustments for hedged risk	53.4	-	-	-	**53.4**	70.3	-	-	-	70.3
Investment securities	1,935.0	-	-	-	**1,935.0**	2,387.7	-	-	-	2,387.7
Derivative financial instruments	192.2	-	-	-	**192.2**	232.4	-	-	-	232.4
Other assets	828.1	26.1	4.5	-	**858.7**	420.0	24.0	4.3	-	448.3
Total assets	**23,054.8**	**39.4**	**8.2**	**0.4**	**23,102.8**	24,433.5	38.4	17.6	0.6	24,490.1
Liabilities[1]										
Deposits by banks	1,433.5	-	-	-	**1,433.5**	1,122.7	-	-	-	1,122.7
Customer accounts[1]	18,735.8	-	-	-	**18,735.8**	20,624.7	3.9	6.0	0.4	20,635.0
Debt securities in issue	617.6	-	-	-	**617.6**	627.4	-	-	-	627.4
Derivative financial instruments	260.6	-	-	-	**260.6**	315.0	-	-	-	315.0
Other liabilities	306.1	(0.2)	(0.6)	(0.1)	**305.2**	284.3	-	0.1	-	284.4
Total liabilities	**21,353.6**	**(0.2)**	**(0.6)**	**(0.1)**	**21,352.7**	22,974.1	3.9	6.1	0.4	22,984.5
Net assets	**1,701.2**	**39.6**	**8.8**	**0.5**	**1,750.1**	1,459.4	34.5	11.5	0.2	1,505.6

1. All currencies are consistent between the Group and Bank Company reporting. There is a £0.1m (2017: £0.1m) difference between the Group and Bank Customer accounts balance but this is a sterling balance.

At 31 December 2018, the Bank's open currency position was £(0.4)m (2017: £(0.4)m). Currency positions are managed against both an overall limit and individual currency limits.

Other sources of market risk – unaudited

Other sources of market risk include:

- prepayment risk – the risk that an asset or liability repays more quickly or slowly than anticipated, resulting in a mismatch between the asset, liability and associated hedge;
- pipeline risk – the risk that the sales profile for new fixed rate products do not match hedging assumptions, resulting in a mismatch between amount of product sold and that hedged, which can result in a hedge rebalancing cost;
- explicit option risk – the sensitivity to overall direction of interest rates, speed of change of interest rates and market prices for positions which contain explicit options e.g. caps, floors, and swaps. The Bank no longer has exposure to explicit option risk as its holding of equity linked capital bonds matured in December 2017. There are no plans to resume offering these products;
- repricing and implicit optionality in products – the risk that options embedded or implied within retail or commercial products have an impact on market value or earnings with changing interest rates;
- illiquidity risk – the Bank's risk appetite for market risk considers an illiquidity risk which is reflected in the assumed holding period it uses to assess its capital requirements for market risk; and
- equity price risk – the risk that the fair value of equities decreases as a result of changes in the level of equity indices and individual stocks. Non-trading equity price risk exposure arises from equity securities classified as fair value through profit and loss. A 10% increase in the value of equities at 31 December 2018 would equate to an increase of £2.6m (2017: £2.7m). An equivalent decrease would reduce the value by the same degree.

Unaudited

Market risk indicators	2018	2017
Total PV01 (£k)	**12.0**	12.0
Average PV01 for the year (£k)	**(26.2)**	4.4
Largest positive PV01 for the period (£k)	**30.0**	79.0
Largest negative PV01 for the period (£k)	**(113.0)**	(51.0)
Average basis risk (% of annual NII)	**1.4%**	0.7%
Swap spread PV01 (£k)	**(837.0)**	(779.0)
Average swap spread PV01 (£k)	**(865.8)**	(799.9)
RMBS holding (£m)	**487.0**	907.7
Average RMBS holding (£m)	**754.0**	1,004.2
FX notional (£m)	**(0.4)**	(0.4)
Average FX notional (£m)	**0.2**	(0.4)

The table illustrates the PV01, basis risk, swap spread and FX risk metrics on the 2018 year-end balance. The PV01 is primarily driven by the non-sensitive balances offset by corresponding asset or derivative positions. During 2018, the largest absolute PV01 exposure of £(113)k reflected the increase in fixed mortgage pipeline absorbed within the overall PV01 limit.

The basis risk exposure, in terms of potential earnings at risk and notional, primarily reflects a net LIBOR asset funded by an administered rate net liability. Swap spread risk has continued to reduce through 2018 due to a reduction in both notional value and duration of the fixed rate sovereign bonds held within its liquid asset portfolio. RMBS holdings have reduced by approximately £421m reflecting an outright sale of a portion of the Warwick Finance holdings and the impact of the quarterly amortisation of these notes.

4.3 Hedge accounting - audited

The Group is exposed to interest rate risk arising from changes in market interest rates. A variety of strategies are employed to mitigate interest rate risk with the overall objective of hedging interest rates paid and received, back to three-month LIBOR. To reduce the reporting volatility introduced as a result of entering into derivatives for economic hedging purposes, the Group applies hedge accounting. The hedge accounting strategies applied are as follows:

Strategy	Hedging instruments and underlying hedged items	Objective of strategy
1) Macro fair value hedge	Interest rate risk on fixed rate mortgages and customer loans.	Macro hedge accounting is used to recognise fair value changes related to changes in net interest rate risk in the fixed rate mortgages and customer loans and therefore reduce the profit or loss volatility that would otherwise arise from changes in the fair value of the interest rate swaps alone.
2) Micro fair value hedge	Interest rate risk on certain fixed rate treasury assets and liabilities.	Micro fair value hedge accounting is used to recognise fair value changes related to changes in interest rate risk in certain treasury assets\liabilities and therefore reduce the profit or loss volatility that would otherwise arise from changes in the fair value of the interest rate swaps alone.
3) Macro cash flow hedge	Reset risk on variable rate loans and mortgages.	Macro cash flow accounting is used to mitigate reporting volatility as a result of entering into interest rate swaps to economically hedge market risk on non-interest bearing deposits. The related interest rate swaps are designated in a cash flow hedge accounting relationship with variable rate loans and mortgages of similar maturity. Provided the hedge is effective, changes in the fair value of the interest rate swaps are initially recognised in a hedging reserve in equity via the statement of other comprehensive income. They are transferred (recycled) to the income statement when the hedged transaction affects profit or loss. The ineffective portion of the change in the fair value of the hedging instrument (if any) is recognised directly in profit or loss.

Interest rate risk on fixed rate mortgages and customer deposits (macro fair value hedge)
The Group is exposed to interest rate risk on its fixed rate mortgages and customer loans due to changes in LIBOR. The move towards SONIA is still being formulated (see market risk 4.2). This interest rate risk is managed by entering into pay fixed/receive floating externally-traded interest rate swaps. Such interest rate swaps are entered into on a regular basis (as and when interest exposure is identified). Only the interest rate risk element is hedged and therefore other risks, such as credit risk, are managed but not hedged.

To mitigate volatility in the income statement generated by this hedge relationship, macro fair value hedge accounting is applied. Relevant interest rate swaps are immediately designated in a hedge accounting relationship. Prospectively the hedging relationship is established by matching the fixed flows of the derivatives against the fixed flows of the portfolio of items being hedged.

The interest rate risk component of the underlying hedged item is determined using proxy derivatives. The fair value change in these proxy derivatives due to changes in LIBOR are compared to the fair value changes in the hedging swaps due to changes in LIBOR and SONIA. The relationship of these two fair value movements will determine the retrospective hedge ratio. The main sources of ineffectiveness arise from the difference between expected and actual prepayments of mortgages and from SONIAL\IBOR basis spreads.

Interest rate risk on fixed rate treasury assets and liabilities (micro fair value hedge)
The Group enters into micro fair value hedges in relation to certain fixed rate treasury assets and liabilities to manage changes in interest rate risk. The interest rate risk is managed by entering into interest rate swaps.

Only the interest rate risk element is hedged and therefore other risks, such as credit risk, are managed but not hedged. The interest rate risk component is determined under various methodologies as applicable to each instrument being hedged, as the change in the fair value of the hedged items arising solely from changes in LIBOR or SONIA and is usually the largest component of changes in fair value. This strategy is designated as a fair value hedge.

A hedging ratio is established by matching the notional value of derivatives with the principal (or part of the principal) of the instrument being hedged (micro hedge) and running a prospective effectiveness test which compares changes in the values of the hedged item and hedging instrument for a 1 bp move in the underlying yield curves.

Retrospective effectiveness is assessed by comparing changes in the hedged risk with changes in the fair value of interest rate swaps. Possible sources of ineffectiveness include:
- SONIAL\IBOR basis spread (main source of ineffectiveness);
- imperfect economic hedges as the derivatives are not always an exact match for the risk in the hedged item; and
- LIBOR fixings on the floating swap leg.

Reset risk on variable rate loans and mortgages (macro cash flow hedge)
The Group enters into pay floating/receive fixed interest rate swaps to manage interest rate risk on non-interest bearing deposits. To mitigate reporting volatility as a result of entering into this economic hedge, the related interest rate swaps are designated in a cash flow hedge accounting relationship with variable rate loans and mortgages of similar maturity. A hedging ratio is established by matching the notional value of the derivatives with a percentage of the principal of the portfolios being hedged.

Retrospective effectiveness is assessed by comparing changes in the hedged risk with changes in the fair value of interest rate swaps, using the hypothetical derivative method. The main source of ineffectiveness arises from SONIA\LIBOR basis spreads. There are no transactions for which cash flow hedge accounting has been used in the previous period and which are no longer expected to occur.

Quantitative hedge accounting information
The following table sets out the maturity profile and average price/rate of micro hedge accounting strategies applied by the Group:

2018	Maturity					
	Up to 1 month	1-3 months	3 months to 1 year	1 year to 5 years	> 5 years	Total
Fair value hedges - interest rate swap						
Notional	-	-	25.0	1,110.2	617.2	**1,752.4**
Average fixed interest rate	-	-	1.13%	1.58%	2.01%	

The following table shows details of the hedging instruments used by the Group:

2018	Carrying amount			Balance sheet line item (s)	Changes in fair value used for calculating hedge ineffectiveness
	Notional	Assets	Liabilities		
Fair value hedges – interest rate risk					
Interest rate swaps	7,552.8	28.6	106.5	Derivative Financial Instruments	(74.0)
Cash flow hedges					
Interest rate swaps	5,991.4	32.7	9.8	Derivative Financial Instruments	21.0

The following table contains details of the hedged exposures covered by the Group's hedging strategies:

	Carrying amount of hedged item		Accumulated amount of fair value adjustments on the hedged item		Balance sheet line item	Change in fair value of hedged item for ineffectiveness assessment	Cash flow hedge reserve	
	Assets	Liabilities	Assets	Liabilities			Continuing hedges	Discontinued hedges
2018								
Macro fair value hedges								
Interest rate risk								
Fixed rate mortgages	5,794.1	-	53.4	-	Loans and Advances to Customers	(16.8)	N/a	N/a
Fixed rate bonds	309.1	-	(0.1)	-	Investment Securities - FVOCI	(0.3)	N/a	N/a
Fixed rate bonds	-	601.5	-	(16.1)	Debt Securities in Issue	10.6	N/a	N/a
Fixed rate gilts	890.3	-	36.3	-	Investment Securities - FVOCI	(34.6)	N/a	N/a
Cash flow hedges								
Interest rate risk								
Floating rate mortgages	1,659.5	-	N/a	N/a	Loans and Advances to Customers	18.9	(21.0)	(5.7)

The accumulated amount of fair value hedge adjustments remaining in the balance sheet for hedged items that have ceased to be adjusted for hedging gains and losses is £9.2m (2017: £14.4m).

The following table illustrates the effectiveness of the designated hedging relationships as well as the impact on the income statement (IS) and other comprehensive income (OCI):

				Amounts reclassified from reserves to IS as:		
2018	**Gain/(loss) recognised in OCI**	**Hedge effectiveness recognised in the IS**	**IS line item that includes hedge ineffectiveness**	**Hedged cash flows will no longer occur**	**Hedged item affected IS**	**IS line item that includes reclassified amount**
Macro fair value hedges						
Interest rate risk						
Fixed rate mortgages	N/a	(3.5)	Other operating (expense)/income net	N/a	N/a	N/a
Fixed rate bonds	N/a	0.9	Other operating (expense)/income net	N/a	N/a	N/a
Fixed rate gilts	N/a	(3.5)	Other operating (expense)/income net	N/a	N/a	N/a
Cash flow hedges						
Interest rate risk						
Floating rate mortgages	(13.2)	-	Other operating (expense)/income net	N/a	(2.8)	Net interest income on financial Instruments not in a hedging relationship (drip of terminated IRS) Net interest income on financial instruments hedging assets (drip of Futures)

The following table shows a reconciliation of each component of equity and an analysis of OCI in relation to hedge accounting:

	2018
Cash flow hedge reserve as at 1 January	**29.9**
Net changes in fair value recognised directly in equity	(16.0)
Transfers from equity to income or expense	2.8
Income tax	3.3
Cash flow hedge reserve as at 31 December	**20.0**

5. LIQUIDITY AND FUNDING RISK

5.1 Overview

The Board determines the level of liquid resources required to support the business objectives through the risk appetite and by undertaking an Internal Liquidity Adequacy Assessment Process (ILAAP). The ILAAP process involves the review of the liquidity Risk Management Framework, the assessment of the exposure to qualitative and quantitative liquidity and funding risks (including under stressed conditions) and concludes on the adequacy of its liquid resources.

The ILAAP and compliance with the Overall Liquidity Adequacy Rule (OLAR) is reviewed and approved by the Board. The Liquidity Coverage Ratio (LCR) is the Bank's primary regulatory liquidity metric. The LCR was introduced in 2015 and the minimum requirement has increased gradually until reaching 100% from 1 January 2018. Following review of the Bank's ILAAP, the Prudential Regulation Authority (PRA) provides Individual Liquidity Guidance (ILG) which determines the amount of eligible liquidity which is required to be held, including Pillar 2 in respect of liquidity risks not captured by the LCR.

The Bank also monitors its position against the regulatory Net Stable Funding Ratio (NSFR) metric, which is a longer term funding metric.

To manage liquidity and funding risk the following are monitored:

- funding and cashflow profile;
- maturity concentrations;
- total liquid asset portfolio;
- asset encumbrance;
- stress testing; and
- assessing market conditions for stress and contingency planning.

The Group has an established funding base, predominantly comprising retail and commercial deposits. The liquidity position is monitored and managed, maintaining a regulatory liquidity buffer appropriate for our funding profile in order to ensure financial obligations are met as and when they fall due. In a more severe stress, the Bank has a Contingency Funding Plan (CFP) which would be invoked. The Bank is additionally required to maintain a Recovery and Resolution Plan (RRP), maintained under UK regulatory rules implementing the European Bank Recovery and Resolution Directive (BRRD), which documents a number of potential management actions.

5.2 Liquidity Risk Management Framework and risk policies - unaudited

Liquidity management information is provided on a regular basis to ALCo and the Board which details compliance with key liquidity risk metrics, which include:

- LCR: 153.8% (2017: 213.0%) which represents a surplus to regulatory requirements. The strong liquidity position aligns to the risk strategy to maintain a prudent liquidity position, although the surplus to regulatory requirements may vary due to cash flow mismatches and fluctuations in the funding profile over time;
- Internal liquidity stress tests: measures the survival period under an applicable stress scenario. A buffer was held in excess of the requirements from the applicable stress scenario at 31 December 2018;
- Customer loan/deposit ratio: 94.7% (2017: 81.1%) the ratio of customer loans (excluding credit commitments) to customer deposits;
- NSFR: based on current interpretations of requirements and guidance, the Bank's NSFR was 138.2% (2017: 150.0%), exceeding the expected 100% minimum future requirement; and
- Encumbrance ratio: 19.9% (2017: 15.1%). According to the European Banking Authority (EBA) definition the asset encumbrance ratio is calculated as the carrying amount of encumbered assets and collateral divided by total assets and collateral.

An asset is defined as encumbered if it has been pledged as collateral against an existing liability or to collateralise an exposure that the Group may have, restricting access to that asset in the event of resolution or bankruptcy. An encumbered asset would be no longer available to use in secured funding, to satisfy collateral needs, or to be sold to reduce the funding requirement. The encumbrance table is presented in the Pillar 3 disclosures (5.3 liquidity and funding –table 34).

5.3 Liquid asset portfolios – unaudited

Total liquidity resources as at 31 December 2018 were £7,025.0m (2017: £9,965.2m). There is a focus on maintaining a high percentage of liquid assets which are high-quality and the table below analyses the liquidity portfolio by product and unencumbered liquidity value. The liquidity portfolio is categorised into primary and secondary (other liquid assets and contingent liquidity).

Primary liquid assets include cash and balances at central banks, gilts and other high quality government bonds (all are eligible under European Banking Authority (EBA) regulations (High Quality Liquid Assets). The reduction in primary liquidity related mainly to the funding received from the Warwick Finance transaction in 2017, being deployed in 2018, returning the Bank's liquidity holdings to a more efficient level.

Secondary liquidity comprises unencumbered liquid investment securities not included as part of primary liquidity, as well as other forms of contingent liquidity sources (mortgage and corporate collateral). The reduction in secondary liquidity is a result of the Bank's management of its holdings of mortgage backed securities (MBS).

Liquidity – primary & secondary	2018	2017
Operational balances with central banks	1,662.2	3,815.5
Gilts	532.1	423.1
Central government and multilateral development bank bonds	467.3	348.7
Total primary liquid assets	**2,661.6**	4,587.3
Other liquid assets	364.0	1,186.1
Contingent liquidity	3,999.4	4,191.8
Total secondary liquid assets	**4,363.4**	5,377.9
Total liquidity	**7,025.0**	9,965.2
Average balance	8,357.9	9,151.5

A combination of these asset pools is used to manage liquidity, with primary liquidity used predominantly for short term cash flow movements, while other liquidity is used for creating longer term liquidity. Regular realisation through repo transactions and outright sales provide assurance that these asset pools remain sufficiently liquid.

Included within the primary liquid asset balance above is £99.4m (2017: £298.7m) of UK government gilts obtained through a collateral upgrade transaction. In accordance within the recognition criteria for financial assets under IFRS 9 Financial Instruments, these gilts are not recognised on the Bank's balance sheet. The disclosures above are based on what is eligible for liquidity purposes and so does not exactly match the balance sheet.

5.3.1 Wholesale funding – unaudited

Wholesale funding is used to supplement retail and commercial deposits to diversify the source of funds to support the strategic plan. There are a variety of long term wholesale funding sources outstanding, including covered bond, repos (including indexed long-term repo) and Bank of England Term Funding Scheme (TFS) as shown in the table below:

Wholesale funding	2018	2017
Secured funding	**1,564.7**	601.9
Repos	**468.8**	1,120.3
Market borrowing	**-**	1.3
	2,033.5	**1,723.5**

The wholesale funding position has been managed by the reduction of Repos and replacement by secured funding driven through the introduction of TFS funds. Gilt repos make up £333.5m of total repo funding. The following table sets out contractual wholesale funding by maturity, with the maturity of securitisations based on call dates. The funding below is included within deposits by banks and debt securities in issue on the balance sheet.

Wholesale funding maturity	2018	2017
Repayable in less than 1 month	**325.6**	1,021.5
Repayable between 1 and 3 months	**95.3**	-
Repayable between 3 and 6 months	**50.1**	100.1
Repayable between 6 and 9 months	**-**	-
Repayable between 9 and 12 months	**-**	-
Repayable between 1 and 2 years	**-**	-
Repayable between 2 and 5 years	**1,562.5**	601.9
Repayable in more than 5 years	**-**	-
	2,033.5	1,723.5

5.4 Liquidity gap – audited

Details of contractual maturities for assets and liabilities underpin the management of liquidity risk. However, management recognises that customer behaviour differs to contractual maturity, therefore as part of the planning process, behavioural run-off of customer assets and liabilities over time are estimated. The assumptions used to create these estimates and the estimates themselves are recommended for approval by ALCo as part of its responsibility to manage the strategic plan.

Gross cash flows include interest and other revenue cash flows. Other assets and liabilities include non-financial items and these are excluded from the maturity analysis. The following table is an analysis of gross undiscounted contractual cash flows of financial assets and liabilities held at the balance sheet date:

2018 – Contractual cash flows	**Carrying value**	**Gross nominal flow**	**Less than 1 month**	**1-3 months**	**3-6 months**	**6-9 months**	**9-12 months**	**1-2 years**	**2-5 years**	**Over 5 years**
Assets										
Cash and balances at central banks	1,843.8	**1,843.8**	1,843.8	-	-	-	-	-	-	-
Loans and advances to banks	485.8	**485.9**	404.1	81.8	-	-	-	-	-	-
Loans and advances to customers	17,733.9	**26,938.2**	534.3	211.2	314.6	320.6	325.4	1,294.2	4,011.8	19,926.1
Investment securities	1,935.0	**2,181.7**	4.2	8.2	12.4	12.5	37.6	443.5	845.8	817.5
Derivative financial instruments	192.2	**321.4**	13.3	11.5	11.9	11.6	11.1	38.5	65.8	157.7
Other assets	912.1	**-**	-	-	-	-	-	-	-	-
Total recognised assets	**23,102.8**	**31,771.0**	**2,799.7**	**312.7**	**338.9**	**344.7**	**374.1**	**1,776.2**	**4,923.4**	**20,901.3**
Liabilities										
Deposits by banks	1,433.5	**1,462.0**	329.0	96.9	52.3	2.2	2.3	8.9	970.4	-
Customer accounts[1]	18,735.8	**18,789.2**	14,756.5	297.9	829.2	1,259.0	605.0	787.1	254.5	-
Debt securities in issue	617.6	**685.6**	2.4	4.6	7.0	7.1	11.2	28.5	624.8	-
Derivative financial instruments	260.6	**430.3**	7.2	16.1	12.9	17.4	12.4	44.5	100.3	219.5
Other liabilities	305.2	**-**	-	-	-	-	-	-	-	-
Total recognised liabilities	**21,352.7**	**21,367.1**	**15,095.1**	**415.5**	**901.4**	**1,285.7**	**630.9**	**869.0**	**1,950.0**	**219.5**
Unrecognised loan commitments	2,247.4	**2,247.4**	2,247.4	-	-	-	-	-	-	-
Total liabilities	**23,600.1**	**23,614.5**	**17,342.5**	**415.5**	**901.4**	**1,285.7**	**630.9**	**869.0**	**1,950.0**	**219.5**

2017 - Contractual cash flows	Carrying value	Gross nominal flow	Less than 1 month	1-3 months	3-6 months	6-9 months	9-12 months	1-2 years	2-5 years	Over 5 years
Assets										
Cash and balances at central banks	4,032.1	4,032.1	4,032.1	-	-	-	-	-	-	-
Loans and advances to banks	574.8	576.7	476.7	98.5	0.3	0.1	0.2	0.6	0.3	-
Loans and advances to customers (incl. FVAHR)	16,814.8	24,669.9	543.5	224.6	334.4	325.0	348.9	1,267.9	3,817.4	17,808.2
Investment securities:										
Loans and receivables	100.0	142.6	0.1	0.2	0.3	0.3	0.3	1.4	4.1	135.9
Available for sale	2,287.7	2,387.5	3.5	6.7	10.2	10.3	12.1	179.2	1,552.0	613.5
Fair value through profit or loss	-	-	-	-	-	-	-	-	-	-
Derivative financial instruments	232.4	393.8	13.5	12.0	12.6	12.3	12.3	47.0	84.5	199.6
Other assets	448.3	-	-	-	-	-	-	-	-	-
Total recognised assets	24,490.1	32,202.6	5,069.4	342.0	357.8	348.0	373.8	1,496.1	5,458.3	18,757.2
Liabilities										
Deposits by banks	1,122.7	1,128.9	1,023.2	1.1	101.2	0.4	0.4	1.8	0.8	-
Customer accounts[1]	20,635.0	20,703.8	15,520.5	270.1	1,007.7	1,440.2	716.9	1,479.6	268.8	-
Debt securities in issue	627.4	714.1	2.4	4.6	7.0	7.1	11.2	28.5	653.3	-
Derivative financial instruments	315.0	548.0	9.2	23.3	17.4	21.9	16.8	60.0	124.6	274.8
Other liabilities	284.4	-	-	-	-	-	-	-	-	-
Total recognised liabilities	22,984.5	23,094.8	16,555.3	299.1	1,133.3	1,469.6	745.3	1,569.9	1,047.5	274.8
Unrecognised loan commitments	2,411.0	2,411.0	2,110.9	300.1	-	-	-	-	-	-
Total liabilities	25,395.5	25,505.8	18,666.2	599.2	1,133.3	1,469.6	745.3	1,569.9	1,047.5	274.8

1. The carrying value of customer accounts for the Bank is £18,735.9m (2017:£20,635.1m) and the gross nominal flow is £18,789.3m (2017: £20,703.9m). The additional £0.1m (2017: £0.1m) is within the less than 1 month band. All other balances and timing bands are consistent with Group.

The principal difference between the gross nominal value and the accounting carrying value set out above is due to discounting. Discounting has a greater impact on cash flows in later years, and a minimal impact on cash flows within 1 year. Therefore the contractual cash flows on assets and liabilities expected in less than one year are a fair representation of the contractual maturity of current assets and liabilities at carrying value in the balance sheet.

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INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF THE CO-OPERATIVE BANK PLC

Opinion

In our opinion:

- The Co-operative Bank plc's group financial statements (the "Bank") and the parent company, The Co-operative Bank plc (the "Bank Company") financial statements (together the "financial statements") give a true and fair view of the state of the Bank's and of the Bank Company's affairs as at 31 December 2018 and of the Bank's loss for the year then ended;
- the Bank financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union;
- the Bank Company financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union as applied in accordance with the provisions of the Companies Act 2006; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006, and, as regards the Bank financial statements, Article 4 of the IAS Regulation.

We have audited the financial statements of the Bank Company and its subsidiaries (together, the "Bank") which comprise:

Bank	Bank Company
Consolidated balance sheet as at 31 December 2018	Balance sheet as at 31 December 2018
Consolidated income statement for the year then ended	Statement of changes in equity for the year then ended
Consolidated statement of comprehensive income for the year then ended	Statement of cash flows for the year then ended
Consolidated statement of changes in equity for the year then ended	Related notes 1 to 26 to the financial statements, (except for note 20 which is marked as unaudited), including a summary of significant accounting policies
Consolidated statement of cash flows for the year then ended	
Related notes 1 to 36 to the financial statements, (except for note 29 which is marked as unaudited), including a summary of significant accounting policies	
Information in the capital and risk management section of the Business Review, identified as "audited" on pages 60 to 102	

The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union and; as regards to the Bank Company financial statements, as applied in accordance with the provisions of the Companies Act 2006.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)) and applicable law. Our responsibilities under those standards are further described in the Auditor's responsibilities for the audit of the financial statements section of our report below. We are independent of the Bank and Bank Company in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the FRC's Ethical Standard as applied to listed public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Conclusions relating to going concern

We have nothing to report in respect of the following matters in relation to which the ISAs (UK) require us to report to you where:

- the directors' use of the going concern basis of accounting in the preparation of the financial statements is not appropriate; or
- the directors have not disclosed in the financial statements any identified material uncertainties that may cast significant doubt about the Bank's or the Bank Company's ability to continue to adopt the going concern basis of accounting for a period of at least 12 months from the date when the financial statements are authorised for issue.

Overview of our audit approach

Key audit matters	• Valuation of credit impairment provisions • Valuation of conduct and compliance risk provisions • Recognition of income using the Effective Interest Rate ("EIR") method • Valuation of the surrendered loss debtor • Macro hedge accounting models • Valuation of the PACE pension scheme • The Bank's control environment
Audit scope	• We performed an audit of the complete financial information of the Bank and Bank Company.
Materiality	• Overall group materiality of £10 million which represents 0.57% of equity.

Key audit matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the financial statements of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) that we identified. These matters included those which had the greatest effect on: the overall audit strategy, the allocation of resources in the audit; and directing the efforts of the engagement team. These matters were addressed in the context of our audit of the financial statements as a whole, and in our opinion thereon, and we do not provide a separate opinion on these matters.

Risk	Our response to the risk	Key observations communicated to the Audit Committee
Valuation of credit impairment provisions Please refer to the Audit Committee report (page 35); accounting policies (page 121); and note 14 of the consolidated financial statements (page 147). The provision for impairment of loans and advances to customers is a significant balance and carries a high degree of estimation uncertainty derived from the assumptions and judgments used to build the provision. The application of IFRS 9, effective for the year ended 31 December 2018, results in fundamental changes to how impairment provisions are determined as IFRS 9 requires a forward looking assessment of expected loss, as opposed to the incurred loss model used under IAS 39. The requirement to determine the transition adjustment for the opening balance sheet results in additional complexity in the year. The continued deleveraging and reduction in risk within the Bank's loan portfolio has also been taken into account in determining the level of audit risk. Considering the magnitude of the provision balance, the level of estimation uncertainty and uncertainty in the UK economy as a result of Brexit, the valuation of credit impairment provisions remains a key audit matter. The inherent ability of Management to override internal controls in relation to credit impairment provisions also represents a risk of fraud.	**Our response:** We understood and evaluated the design effectiveness of key controls over the impairment process, and validated the operating effectiveness of the controls we placed reliance on. This includes controls over the processes for data governance and forward-looking assumptions, as well as controls in relation to the review of specific provisioning on corporate loans. Our substantive audit procedures over the collective IFRS 9 provision models included assessing, challenging and substantiating Management's key assumptions, such as: definition of default, probability of default ("PD"), loss given default, significant increases in credit risk and the staging applied by Management, forward looking assumptions and the determination of lifetime PD curves. In order to assess the Bank's modelled provisions, we used credit modelling specialists to perform substantive procedures over the model build, perform sensitivity analysis and determine whether any indications of model weakness exist which could reasonably give rise to a material misstatement. For a sample of higher risk corporate stage 3 provision cases we obtained an understanding of the latest developments in the borrower's situation and the factors impacting the measurement of provisions. In each case we tested key data inputs and, where relevant, considered alternative scenarios in challenging Management's estimate. The Bank derives its individual impairment provisions with reference to the collateral held against each impaired loan. Our approach included the use of our own valuation specialists to assess the market value of a sample of collateral valuations. We engaged with our economic specialists to assess the macro-economic factors considered in the forward-looking assumptions, including the probability weighting applied to each scenario. We also assessed the completeness of model overlays using our knowledge and experience across the banking sector and tested material overlays for reasonableness of estimation.	We concluded to the Audit Committee that the provision levels held by the Bank in relation to credit impairment were reasonably estimated and in line with the new requirements of IFRS 9. We highlighted the following matters: • Based on our validation of the transitional impact of IFRS 9, we concluded that the opening balance sheet position is materially correct. • Following our assessment of stage 3 provisions, including the independent valuation of collateral, we concluded that Management's estimates were reasonable and the collateral held was appropriately valued. • We considered the multiple economic scenarios incorporated in the IFRS 9 models to be reasonable. We have noted a number of limitations in the Bank's IFRS 9 models, and that Management has included overlays to address the risk associated with these limitations.

Risk	Our response to the risk	Key observations communicated to the Audit Committee
Valuation of conduct and compliance risk provisions Please refer to the Audit Committee report (page 35); accounting policies (page 121); and note 26 of the consolidated financial statements (page 154). The Bank carries a number of provisions for various matters including those related to the conduct of the Bank towards its past and present customers, including: • Payment Protection Insurance mis-selling ("PPI") • Packaged Bank Accounts mis-selling ("PBA") • Unclear terms and conditions with respect to a population of further advances The assessment of present obligations for customer redress requires significant judgement due to the uncertainties over whether an obligation exists and the subjective assumptions used to quantify potential redress levels once an obligation is confirmed as existing. Whilst the risk has reduced during the year, the magnitude of the provisions, and level of judgement involved means that this remains a key audit matter. The ability of Management to override internal controls in relation to conduct and compliance risk provisions also represents a significant risk of fraud.	**Our response:** We performed a walkthrough of the Bank's processes for calculating and recording conduct and compliance risk provisions, including any changes in the calculation methodology, and assessed the design effectiveness of key controls. We tested the completeness and accuracy of data used by the Bank in creating the provisions using the Bank's models. We modelled the impact of reasonably possible alternative assumptions on each of the Bank's conduct provision balances and developed independent ranges of outcomes to evaluate and challenge Management's provision estimates. We engaged our conduct risk specialists to perform an independent assessment of PPI complaint outcomes with reference to source documentation, and also recalculate a sample of redress amounts that have been offered to customers. Completeness of the identification of conduct issues (with the potential to lead to provisions) was assessed through discussions with Management, including General Counsel, review of regulatory correspondence and, through discussions with our conduct risk specialists, consideration of broader industry issues and developments.	We concluded to the Audit Committee that the provision levels held by the Bank in relation to conduct and compliance risk are reasonably estimated and recognised in accordance with IFRS. We also concluded that the Bank's disclosures, including the sensitivities disclosed in note 2, were appropriate and in compliance with the relevant accounting standards. We highlighted the following matters: • The PPI provision remains sensitive to key assumptions, the most significant of which is future complaint volumes. • Other conduct and compliance provisions are uncertain due to the judgement involved in identifying affected customer populations and future complaint volumes.
Recognition of income using the Effective Interest Rate ("EIR") method Please refer to the Audit Committee report (page 35); accounting policies (page 121); and note 33 of the consolidated financial statements (page 166). The EIR method of revenue recognition involves significant Management judgement and complex calculations in both determining the initial EIR and recording the present value of adjustments arising in subsequent periods when cash flows are reforecast. As such, it represents a risk of fraud in revenue recognition and through Management override of internal controls. The Bank's EIR models are most sensitive to changes in the behavioural life assumptions and future interest rate expectations. Modelled forecast cash flows may be measured incorrectly due to the use of inaccurate or incomplete data, erroneous formulae or inappropriate assumptions being used. Due to the degree of judgement that needs to be exercised by Management around forecast future cash flows; the number of different products the Bank has across its loan portfolio and the complexity of calculation, this remains a key audit matter.	**Our response:** We performed a walkthrough of the EIR process and gained an understanding of key controls. We also assessed the design effectiveness of these controls. We validated and challenged assumptions used by Management in the EIR models, including the behavioural lives of assets and the forecasting of standard variable rates. We compared customer redemption assumptions with recent customer behaviours observable in the Bank's portfolios, and assessed the consistency of forecast standard variable rates with market derived base rate forecasts and the Bank's expectations of future interest margins. We reviewed the appropriateness of key model assumptions in light of our knowledge of the Bank's portfolios and market conditions. We tested the completeness and accuracy of data within these models through agreeing the model data to the Bank's source systems. We tested the accuracy of the EIR calculations by recalculating the EIR balance for a sample of mortgages and agreeing this to the model balance.	We concluded to the Audit Committee that the approach taken results in a reasonable estimate in the context of current observable market behaviours and economic conditions. We also highlighted that there is subjectivity in Management's assumptions concerning behavioural lives and future rates of interest. We were satisfied that the assumptions made by Management are reasonable in the context of the Bank's mortgage portfolios and current market conditions.

Risk	Our response to the risk	Key observations communicated to the Audit Committee
Valuation of the surrendered loss debtor Please refer to the Audit Committee report (page 35); accounting policies (page 121); and note 18 of the consolidated financial statements (page 151). As part of the negotiations relating to the separation of the Bank from the Co-operative Group ("tCG"), terms were revised relating to the surrender of group relief between the entities in the Bank's tax group and entities in tCG tax group. A deed sets out the basis of the agreement by tCG to take proactive steps to allow it to maximise its claim for tax losses from the Bank, and addresses the terms of the payment by tCG to the Bank for those tax losses. The Bank receives payment when tCG realises the benefit of the losses surrendered and at the corporation tax rate at the point at which the benefit is realised. The valuation of the asset is subject to various assumptions in relation to the timing and amount of cash flows, and the rate at which those cash flows should be discounted. The complexity of this matter has increased in the year due to changes in tax legislation which restrict the losses that tCG can use, and the change in accounting treatment of the surrendered loss debtor following the implementation of IFRS 9, and the impact of IFRS 15 and IFRS 16 on the projected future results of tCG which subsequently impact the timing and amount of cash flows to the Bank. Due to the increased degree of estimation uncertainty and the magnitude of the balance, we have considered this a key audit matter.	**Our response:** We walked through the process the Bank follow in calculating the surrendered loss debtor balance and assessed the design effectiveness of key controls. We obtained the deed between tCG and the Bank to validate the existence of the debtor and confirm the terms of the agreement. We have used our modelling specialists to assess Management's forecast cash flow calculation, and have agreed the inputs to the source information received from tCG. We used our valuation specialists to determine an independent range of valuations for the surrendered loss debtor, with reference to historical experience and considering plausible alternative assumptions. We evaluated and challenged Management's estimate against this independent range. We critically assessed the appropriateness of Management's application of UK tax legislation in calculating the fair value estimate. We also evaluated the surrendered loss debtor against the requirements of IFRS 9.	We concluded to the Audit Committee that the fair value of the Bank's surrendered loss debtor was reasonably estimated and in accordance with the requirements of IFRS 9. We highlighted the following matters: • The valuation of the surrendered loss debtor remains sensitive to a number of assumptions, particularly the timing and amount of cash inflows from tCG. • The surrendered loss debtor is uncertain due to the crystallisation of this receivable being dependent on the future performance of tCG, and future tax legislation, over which the Bank has no control.

Risk	Our response to the risk	Key observations communicated to the Audit Committee
Macro hedge accounting models Please refer to the Audit Committee report (page 35); accounting policies (page 121); and note 16 of the consolidated financial statements (page 150). The Bank's macro cash flow and macro fair value hedge accounting models are governed by complex accounting rules and comprise the application of significant assumptions in the determination of the notional balance forecasts, future cash flow forecasts, hedging instrument valuations and the calculation of hedge ineffectiveness. As a result, there is a risk that the methodology or assumptions used in the valuation of hedged items and hedge effectiveness within the models may be inappropriate, or that the modelled forecast hedge item balances or cash flows may be inaccurate due to the application of inaccurate data, inappropriate formulae or incorrect assumptions. Due to the complexity of calculations, the degree of judgement that needs to be exercised by Management around forecast cash flows, errors noted in the prior year and challenges faced in the reconciliation of source system data to the models, this is considered a significant audit risk and key audit matter in the current year.	**Our response:** We walked through the Bank's macro hedge accounting models and assessed the design effectiveness of key controls in the process. We examined any changes to existing hedge documentation to ensure compliance with IAS 39 criteria. We used our specialists to review changes made to Management's macro hedging models, including the methodology and assumptions used. We also assessed the assumptions used to create modelled forecast cash flows for the hedged items in the macro cash flow hedge and macro fair value hedge models. We corroborated the assumptions for consistency with those used in the Bank's other hedging models. We reconciled model inputs to underlying source systems to evaluate the completeness and accuracy of the hedged item and hedging instruments. We verified the clerical accuracy of the models. We used our valuations specialists to test the fair value attributable to hedged risk of hedged items, through testing the value of the ineffectiveness, with reference to independent market data. We independently recalculated the hedge effectiveness throughout the reporting period on a sample basis, and evaluated our results against the hedge effectiveness thresholds defined by IAS 39.	We concluded to the Audit Committee that the Bank's macro hedge accounting models were materially in line with the hedge accounting provisions of IAS 39, ineffectiveness recorded in the income statement was materially correct and there were no hedge relationships that should have been discontinued. We highlighted the following matters: • Appropriate market data had been used as inputs to the fair value attributable to the hedged risk on hedge items. • The assumptions used to create modelled forecast balances of the hedged item in the macro cash flow hedge model and the forecast cash flows in the macro fair value hedge model were appropriate. • Data flows into the models were found to be materially complete and accurate. • We did not note any material misstatements from recalculation of hedge effectiveness on a sample basis.
Valuation of the PACE pension scheme Please refer to the Audit Committee report (page 35); accounting policies (page 121); and note 28 of the consolidated financial statements (page 157). The Bank continues to participate in the PACE pension scheme, which comprises both defined benefit and defined contribution sections. However, the Bank has historically accounted for its obligations to the defined benefit section on a defined contribution basis having concluded that it has been unable to accurately estimate its share of the scheme assets and liabilities. In 2018, legal sectionalisation of the PACE pension scheme was agreed, which has given the Bank increased certainty over its share of the scheme. As such, the Bank has accounted for its share of the defined benefit liabilities on a defined benefit basis, under IAS 19, in the 2018 financial statements. Due to the increased complexity of this approach, and the magnitude of the balances involved, this is considered to be a key audit matter.	**Our response:** We walked through the Bank's process for valuing the PACE pension scheme and assessed the design effectiveness of key controls. We validated that PACE sectionalisation was legally confirmed, and concurred with Management's assessment that, as a result, there was sufficient certainty to account for the scheme liabilities on a defined benefit basis, in accordance with IAS 19. We engaged our pension actuaries to examine the scheme liabilities and assess the appropriateness of the assumptions used by Management. This included assessing the adjustment made to reflect the October 2018 High Court judgement in relation to the equalisation of certain pension benefits payable to men and women. Where appropriate, we obtained third party confirmation of the pension asset balance as at 31 December 2018, and we performed an independent valuation of the listed securities within the asset portfolio. We utilised our valuations specialists to form an independent valuation of assets that do not have a readily available market value.	We concluded to the Audit Committee that the valuation of the PACE pension scheme surplus is reasonably estimated and recognised in accordance with both IAS 19 and IFRIC 14. We highlighted that there is subjectivity in the valuation of the scheme liability due to the use of both financial and geographical assumptions. Overall, we are satisfied that the assumptions made by Management are reasonable.

Risk	Our response to the risk	Key observations communicated to the Audit Committee
The Bank's control environment Historically we have identified weaknesses in the Bank's control environment in excess of what would be considered normal in the industry. During 2018 the Bank has continued to make improvements to its control environment, particularly in relation to data governance, ledger control and financial reporting. We have observed that the Bank's enhanced Risk Management Framework has been further embedded throughout 2018, and that further improvements have been made to the Bank's Financial Statement Close Process, and Management's understanding of the data sources used in financial reporting, allowing for common data to be reconciled across various elements of the Bank's financial reporting. As the robustness of financial reporting depends on the effective functioning of the underlying operational and financial IT systems, as well as on the effectiveness of the Bank's wider control environment, we deemed this to be a key audit matter.	**Our response:** Our audit approach included an assessment of the effectiveness of the key internal controls that Management rely on for financial reporting. We planned our audit to place reliance, where possible and appropriate, on those internal controls including IT general controls where these were determined to be operating effectively. We have also obtained internal audit's report confirming the closure of the Risk Management Framework control theme in the year following the successful embedding of this framework in the Bank. We used IT specialists within our audit team to conduct our IT procedures, which included, amongst others, testing IT general controls relating to systems access and change management, and testing controls over specific IT applications which are required to operate effectively to mitigate the risk of material misstatement within the financial statements. When we were unable to place such reliance, we addressed the increased risk by designing and then executing audit procedures to obtain a greater proportion of evidence from substantive testing and the use of increased sample sizes. We have reconciled the key data sources used by the Bank across the different areas of financial reporting and understood any material variances.	We highlighted to the Audit Committee that further improvements had been made to the Bank's overall control environment during 2018, and that although some areas of weakness remain, we no longer consider these to be materially out of line with industry peers.

In the prior year, our auditor's report included a key audit matter in relation to going concern. In the current year, we have considered that as a result of the successful delivery of the Bank's Restructuring and Recapitalisation, which contributed to the Bank meeting its Individual Capital Guidance and Combined Buffer requirements in late 2017, that, although important considerations relating to the going concern assumption remain, the risks associated with going concern have decreased sufficiently during 2018 such that going concern was not one of the most significant matters in the audit and so was not considered to be a key audit matter for the 2018 audit.

As part of our audit we have evaluated the Directors' going concern assessment in order to determine whether the going concern basis of preparation was appropriate, and if any material uncertainties may exist that would cast significant doubt on the Bank's ability to continue as a going concern. Following the completion of these procedures, we concurred with the Directors' view that the going concern basis of preparation was appropriate, and did not identify any material uncertainties. We also assessed whether the Bank's disclosures in relation to going concern adequately reflect the risks inherent to the going concern assessment.

In addressing the seven key audit matters for 2018, we undertook the procedures discussed above, which were designed in the context of the materiality of the financial statements as a whole. Consequently, we do not express any opinion on any individual area taken in isolation.

In addition, we considered whether or not the following fraud risk factors were present in each of these risks and to what degree, being:
- Management override of internal controls;
- Manipulation of revenue recognition; and
- Fraudulent financial reporting.

Our work in each area was specifically designed to address these risks.

An overview of the scope of our audit
Tailoring the scope
The Bank is principally managed from one location in Manchester, with certain functions such as treasury and some corporate activities operated from London. These functions and operations were subject to full scope audit procedures by the Bank audit team.

The Bank also has one subsidiary, Britannia International Limited ("BINT"), which is based in the Isle of Man. In the prior year, BINT was deemed to be a significant component and was subject to a specific scope audit, and detailed instructions were sent to the non-EY auditor of this component. In the current year, BINT was no longer deemed to be a significant component and was instead subject to audit procedures by the Bank audit team.

Our application of materiality
We apply the concept of materiality in planning and performing the audit, in evaluating the effect of identified misstatements on the audit and in forming our audit opinion.

Materiality

The magnitude of an omission or misstatement that, individually or in the aggregate, could reasonably be expected to influence the economic decisions of the users of the financial statements. Materiality provides a basis for determining the nature and extent of our audit procedures.

We determined materiality for the Bank and Bank Company to be £10 million (2017: £10 million), which is 0.57% (2017: 0.65%) of equity. The reason for selecting equity as the basis for our audit materiality consideration is that the Bank's stated focus is to maintain regulatory capital, as it has been loss making for several years. We also see equity as a proxy for regulatory capital, as the main focus for the users of the financial statements given the importance of regulatory capital to the Bank's solvency.

Performance materiality

The application of materiality at the individual account or balance level. It is set at an amount to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements exceeds materiality.

Based on our risk assessments, together with our assessment of the Bank's overall control environment, our judgement was that performance materiality could be set at 50% (2017: 50%) of our planning materiality, namely £5.0 million (2017: £5 million). 50% is at the conservative end of the normal range we use, which is 50% to 75%. We have set performance materiality at this percentage due to the issues highlighted in the prior year as regards the Bank's control environment and also with regard to the level of audit differences we have historically encountered.

Reporting threshold

An amount below which identified misstatements are considered as being clearly trivial.

We agreed with the Audit Committee that we would report to them all uncorrected audit differences in excess of £0.5 million (2017: £0.5 million), which is set at 5% of planning materiality, as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds.

We evaluate any uncorrected misstatements against both the quantitative measures of materiality discussed above and in light of other relevant qualitative considerations in forming our opinion.

Other information

The Other Information comprises the information included in the Annual Report and Accounts, set out on pages 215 to 220, other than the financial statements and our auditor's report thereon. The Directors are responsible for the Other Information.

Our opinion on the financial statements does not cover the Other Information and, except to the extent otherwise explicitly stated in this report, we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the Other Information and, in doing so, consider whether the Other Information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether there is a material misstatement in the financial statements or a material misstatement of the Other Information. If, based on the work we have performed, we conclude that there is a material misstatement of the Other Information, we are required to report that fact.

We have nothing to report in this regard.

Opinions on other matters prescribed by the Companies Act 2006

In our opinion, based on the work undertaken in the course of the audit:

- the information given in the Strategic Report and the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements; and
- the Strategic Report and Directors Report have been prepared in accordance with applicable legal requirements.

Matters on which we are required to report by exception

In the light of the knowledge and understanding of the Bank and Bank Company and its environment obtained in the course of the audit, we have not identified material misstatements in the Strategic Report or Directors' Report. We have nothing to report in respect of the following matters in relation to which the Companies Act 2006 requires us to report to you if, in our opinion:

- adequate accounting records have not been kept by the Bank Company, or returns adequate for our audit have not been received from branches not visited by us; or
- the financial statements are not in agreement with the accounting records and returns; or
- certain disclosures of Directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit

Responsibilities of Directors

As explained more fully in the Directors' responsibilities statement set out on page 29, the Directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view, and for such internal control as the Directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the Directors are responsible for assessing the Bank and Bank Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the Directors either intend to liquidate the Bank or Bank Company or to cease operations, or have no realistic alternative but to do so.

Auditor's responsibilities for the audit of the financial statements
Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

Explanation as to what extent the audit was considered capable of detecting irregularities, including fraud
The objectives of our audit, in respect to fraud, are; to identify and assess the risks of material misstatement of the financial statements due to fraud; to obtain sufficient appropriate audit evidence regarding the assessed risks of material misstatement due to fraud, through designing and implementing appropriate responses; and to respond appropriately to fraud or suspected fraud identified during the audit. However, the primary responsibility for the prevention and detection of fraud rests with both those charged with governance of the entity and management.

Our approach was as follows:

- We obtained an understanding of the legal and regulatory frameworks that are applicable to the Bank and have a direct impact on the preparation of the financial statements. We determine that the most significant are:
  - Companies Act 2006
  - Financial Reporting Council (FRC) rules and guidance
  - Tax Legislation (governed by HM Revenue and Customs)
  - Financial Conduct Authority (FCA) rules
  - CRD IV (Basel III) and Prudential Regulation Authority (PRA) rules
- We understood how the Bank is complying with those frameworks by reviewing relevant committee minutes and reports, holding discussions with the Bank's general counsel and internal audit, amongst others. We inquired as to any known instances of non-compliance or suspected non-compliance with laws and regulations. We also reviewed the Bank's Complaints Management Policy and Whistleblowing Policy.
- We assessed the susceptibility of the Bank's financial statements to material misstatement, including how fraud might occur, by holding discussion with senior management, internal audit, and the Audit Committee.
- Based on this understanding we designed our audit procedures to identify non-compliance with such laws and regulations. Our procedures involved inquiring of key management, reviewing the key policies and reports on the aforementioned legal and regulatory frameworks as well as reviewing the correspondence exchanged with the Regulators.
- The Bank operates in the financial services industry, which is a highly regulated environment. As such, the Senior Statutory Auditor considered the experience and expertise of the engagement team to ensure that the team had the appropriate competence and capabilities, which included the use of specialists where appropriate.

  A further description of our responsibilities for the audit of the financial statements is located on the Financial Reporting Council's website at https://www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditor's report.

Other matters we are required to address

- We were appointed by the Bank at the AGM on 30 May 2014 to audit the financial statements for the year ending 31 December 2014 and subsequent financial periods. Our first engagement letter was signed on 17 July 2014.

  The period of total uninterrupted engagement including previous renewals and reappointments is five years, covering the years ending 31 December 2014 to 31 December 2018.
- The non-audit services prohibited by the FRC's Ethical Standard were not provided to the Bank or the Bank Company and we remain independent of the Bank and the Bank Company in conducting the audit.
- The audit opinion is consistent with our reporting to the Audit Committee

Use of our report
This report is made solely to the Bank Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Bank's and the Bank Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Peter Wallace (Senior statutory auditor)
for and on behalf of Ernst & Young LLP, Statutory Auditor
London
27 February 2019

Notes:

1. The maintenance and integrity of the Bank's web site is the responsibility of the directors; the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the web site.
2. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF THE CO-OPERATIVE BANK HOLDINGS LIMITED

Opinion

We have audited the financial statements of The Co-operative Bank Holdings Limited (the 'Holding Company') and its subsidiaries (the 'Group') for the year ended 31 December 2018 which comprise the Group income statement, the Group and Holding Company balance sheet, Group statement of cash flows, the Group statement of comprehensive income, the Group and Holding Company statement of changes in equity, the capital and risk management section of the Business Review, identified as audited on pages 60 to 102 and the related notes 1 to 36, (except for note 29 which is marked as unaudited), including a summary of significant accounting policies. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union and, as regards the Holding Company financial statements, as applied in accordance with the provisions of the Companies Act 2006.

In our opinion:

- the financial statements give a true and fair view of the Group's and of the Holding Company's affairs as at 31 December 2018 and of the Group's loss for the year then ended;
- the Group financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union;
- the Holding Company financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union in accordance with the provisions of the Companies Act 2006; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)) and applicable law. Our responsibilities under those standards are further described in the Auditor's responsibilities for the audit of the financial statements section of our report below. We are independent of the Group and Holding Company in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the FRC's Ethical Standard, and we have fulfilled our other ethical responsibilities in accordance with these requirements.
We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Conclusions relating to going concern

We have nothing to report in respect of the following matters in relation to which the ISAs (UK) require us to report to you where:

- the Directors' use of the going concern basis of accounting in the preparation of the financial statements is not appropriate; or
- the Directors have not disclosed in the financial statements any identified material uncertainties that may cast significant doubt about the Group's or the Holding Company's ability to continue to adopt the going concern basis of accounting for a period of at least twelve months from the date when the financial statements are authorised for issue.

Other information

The Other Information comprises the information included in the Annual Report and Accounts, set out on pages 215 to 220, other than the financial statements and our auditor's report thereon. The Directors are responsible for the Other Information.

Our opinion on the financial statements does not cover the Other Information and, except to the extent otherwise explicitly stated in this report, we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the Other Information and, in doing so, consider whether the Other Information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether there is a material misstatement in the financial statements or a material misstatement of the Other Information. If, based on the work we have performed, we conclude that there is a material misstatement of the Other Information, we are required to report that fact.

We have nothing to report in this regard.

Opinions on other matters prescribed by the Companies Act 2006

In our opinion, based on the work undertaken in the course of the audit:

- the information given in the Strategic Report and the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements; and
- the Strategic Report and Directors' Report have been prepared in accordance with applicable legal requirements.

Matters on which we are required to report by exception

In the light of the knowledge and understanding of the Group and the Holding Company and its environment obtained in the course of the audit, we have not identified material misstatements in the Strategic Report or Directors' Report.

We have nothing to report in respect of the following matters in relation to which the Companies Act 2006 requires us to report to you if, in our opinion:

- adequate accounting records have not been kept by the Holding Company, or returns adequate for our audit have not been received from branches not visited by us; or
- the Holding Company financial statements are not in agreement with the accounting records and returns; or
- certain disclosures of Directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

Responsibilities of Directors

As explained more fully in the Directors' responsibilities statement set out on page 29, the Directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view, and for such internal control as the Directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the directors are responsible for assessing the Group's and the Holding Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the Directors either intend to liquidate the Group or the Holding Company or to cease operations, or have no realistic alternative but to do so.

Auditor's responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

A further description of our responsibilities for the audit of the financial statements is located on the Financial Reporting Council's website at https://www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditor's report.

Use of our report

This report is made solely to the Holding Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Peter Wallace (Senior statutory auditor)
for and on behalf of Ernst & Young LLP, Statutory Auditor
London
27 February 2019

Notes:

1. The maintenance and integrity of the web site within which these accounts are available is the responsibility of the Directors; the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the web site.
2. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

THE CO-OPERATIVE BANK HOLDINGS LIMITED FINANCIAL STATEMENTS (GROUP)
THE CO-OPERATIVE BANK PLC FINANCIAL STATEMENTS (BANK)
Consolidated income statement
For the year ended 31 December 2018
£millions

		Group		Bank	
	Note	**2018**	2017[1]	**2018**	2017[1]
Interest income calculated using the effective interest method		**503.4**	572.1	**503.4**	572.1
Other interest and similar income		**2.6**	(17.2)	**2.6**	(17.2)
Interest income and similar income	6	**506.0**	554.9	**506.0**	554.9
Interest expense and similar charges	6	**(146.6)**	(291.2)	**(146.6)**	(291.2)
Net interest income		**359.4**	263.7	**359.4**	263.7
Fee and commission income	7	**63.5**	74.8	**63.5**	74.8
Fee and commission expense	7	**(43.3)**	(48.0)	**(43.3)**	(48.0)
Net fee and commission income		**20.2**	26.8	**20.2**	26.8
Income from investments		**0.1**	0.2	**0.1**	0.2
Other operating (expense)/income (net)	8	**(11.0)**	37.0	**(11.0)**	37.0
Operating income		**368.7**	327.7	**368.7**	327.7
Operating expenses	9	**(480.7)**	(532.9)	**(480.7)**	(532.9)
Net customer redress charge	26	**(34.2)**	(27.0)	**(34.2)**	(27.0)
Total operating expenses		**(514.9)**	(559.9)	**(514.9)**	(559.9)
Operating loss before net credit impairment losses		**(146.2)**	(232.2)	**(146.2)**	(232.2)
Net credit impairment gains/(losses)	14	**5.5**	(1.9)	**5.5**	(1.9)
Operating loss before exceptional items		**(140.7)**	(234.1)	**(140.7)**	(234.1)
Gain on Restructuring and Recapitalisation	32	**-**	397.8	**-**	7.4
Gain on pension scheme modification	28	**-**	51.9	**-**	51.9
Operating (loss)/profit after exceptional items		**(140.7)**	215.6	**(140.7)**	(174.8)
Share of post-tax profits from joint ventures		**-**	0.4	**-**	0.4
(Loss)/profit before taxation		**(140.7)**	216.0	**(140.7)**	(174.4)
Income tax	11	**72.0**	16.7	**72.0**	16.7
(Loss)/profit for the financial year		**(68.7)**	232.7	**(68.7)**	(157.7)

1. In accordance with the transitional provisions in IFRS 9, comparative figures have not been restated. See note 36 to the consolidated financial statements for details of changes in accounting policy.

The results above are for the consolidated Group and consolidated Bank and wholly relate to continuing activities. More information regarding the basis of preparation can be found in note 1 to the consolidated financial statements.

The (loss)/profit for the financial year is wholly attributable to equity shareholders.

The notes on pages 121 to 182 form part of these financial statements.

Consolidated statement of comprehensive income
For the year ended 31 December 2018
£millions

	Group		Bank	
	2018	2017[1]	**2018**	2017[1]
(Loss)/profit for the year	**(68.7)**	232.7	**(68.7)**	(157.7)
Items that may be recycled to profit or loss:				
Changes in cash flow hedges:				
Net changes in fair value recognised directly in equity	**(16.0)**	(44.3)	**(16.0)**	(44.3)
Transfers from equity to income or expense	**2.8**	9.0	**2.8**	9.0
Income tax	**3.3**	8.8	**3.3**	8.8
Changes in fair value through other comprehensive income/available-for-sale[2]:				
Net changes in fair value recognised directly in equity	**9.1**	12.3	**9.1**	12.3
Transfers from equity to income or expense	**(14.1)**	(30.0)	**(14.1)**	(30.0)
Income tax	**0.5**	4.6	**0.5**	4.6
Items that may not be subsequently recycled to profit or loss:				
Changes in net retirement benefit asset:				
Recognition of defined benefit asset	**528.9**	-	**528.9**	-
Defined benefit plans (charge)/credit for the year	**(69.5)**	81.6	**(69.5)**	81.6
Income tax	**(114.7)**	(20.3)	**(114.7)**	(20.3)
Other comprehensive income for the financial year, net of income tax	**330.3**	21.7	**330.3**	21.7
Total comprehensive income/(expense) for the financial year	**261.6**	254.4	**261.6**	(136.0)

1. In accordance with the transitional provisions in IFRS 9, comparative figures have not been restated. See note 36 to the consolidated financial statements for details of changes in accounting policy.
2. Changes in fair value of securities classified as changes in fair value through other comprehensive income/available-for-sale.

The results above are for the consolidated Group and consolidated Bank. More information regarding the basis of preparation can be found in note 1 to the consolidated financial statements.

The notes on pages 121 to 182 form part of these financial statements.

Consolidated balance sheet
At 31 December 2018
£millions

	Note	Group		Bank	
		2018	2017[1]	**2018**	2017[1]
Assets					
Cash and balances at central banks	12	**1,843.8**	4,032.1	**1,843.8**	4,032.1
Loans and advances to banks	13	**485.8**	574.8	**485.8**	574.8
Loans and advances to customers	14	**17,733.9**	16,744.5	**17,733.9**	16,744.5
Fair value adjustments for hedged risk		**53.4**	70.3	**53.4**	70.3
Investment securities	15	**1,935.0**	2,387.7	**1,935.0**	2,387.7
Derivative financial instruments	16	**192.2**	232.4	**192.2**	232.4
Property, plant and equipment classified as held-for-sale		**3.9**	2.8	**3.9**	2.8
Equity shares	17	**26.4**	26.6	**26.4**	26.6
Investments in joint ventures	30	**-**	6.3	**-**	6.3
Investment properties		**2.3**	2.3	**2.3**	2.3
Other assets	18	**54.7**	95.3	**54.7**	95.3
Prepayments and accrued income	19	**31.8**	24.7	**31.8**	24.7
Current tax assets		**-**	2.5	**-**	2.5
Property, plant and equipment	20	**40.8**	44.4	**40.8**	44.4
Intangible assets	21	**72.4**	81.5	**72.4**	81.5
Deferred tax assets	27	**2.9**	4.2	**2.9**	4.2
Net retirement benefit asset	28	**623.5**	157.7	**623.5**	157.7
Total assets		**23,102.8**	24,490.1	**23,102.8**	24,490.1
Liabilities					
Deposits by banks	22	**1,433.5**	1,122.7	**1,433.5**	1,122.7
Customer accounts		**18,735.8**	20,635.0	**18,735.9**	20,635.1
Debt securities in issue	23	**617.6**	627.4	**617.6**	627.4
Derivative financial instruments	16	**260.6**	315.0	**260.6**	315.0
Other liabilities	24	**92.1**	34.7	**92.1**	34.7
Accruals and deferred income	25	**63.0**	80.0	**63.0**	80.0
Provisions	26	**103.6**	158.2	**103.6**	158.2
Deferred tax liabilities	27	**38.9**	0.2	**38.9**	0.2
Net retirement benefit liability	28	**7.6**	11.3	**7.6**	11.3
Total liabilities		**21,352.7**	22,984.5	**21,352.8**	22,984.6
Capital and reserves attributable to the Group's and Bank's equity holders					
Ordinary share capital	32	**0.9**	0.9	**25.6**	25.6
Share premium account	32	**313.8**	313.8	**2,416.9**	2,416.9
Retained earnings		**(1,161.5)**	(1,082.4)	**(1,551.9)**	(1,472.8)
Available-for-sale reserve		**-**	25.1	**-**	25.1
Fair value through other comprehensive income reserve		**13.9**	-	**13.9**	-
Capital redemption reserve		**410.0**	410.0	**410.0**	410.0
Cash flow hedging reserve		**20.0**	29.9	**20.0**	29.9
Capital re-organisation reserve	32	**1,737.5**	1,737.5	**-**	-
Defined benefit pension reserve		**415.5**	70.8	**415.5**	70.8
Total equity		**1,750.1**	1,505.6	**1,750.0**	1,505.5
Total liabilities and equity		**23,102.8**	24,490.1	**23,102.8**	24,490.1

1. In accordance with the transitional provisions in IFRS 9, comparative figures have not been restated. See note 36 to the consolidated financial statements for details of changes in accounting policy.

The results above are for the consolidated Group and consolidated Bank. More information regarding the basis of preparation can be found in note 1 to the consolidated financial statements.

The notes on pages 121 to 182 form part of these financial statements.

Approved by the Board of The Co-operative Bank Holdings Limited on 27 February 2019:

Robert Dench Chairman	Andrew Bester Chief Executive Officer

Approved by the Board for The Co-operative Bank plc on 27 February 2019:

Robert Dench Chairman	Andrew Bester Chief Executive Officer

Consolidated statement of cash flows
For the year ended 31 December 2018
£millions

	Note	Group		Bank	
		2018	2017[1]	**2018**	2017[1]
Cash flows used in operating activities:					
(Loss)/profit before taxation		**(140.7)**	216.0	**(140.7)**	(174.4)
Adjustments for non-cash movements:					
Gain on Restructuring and Recapitalisation		**-**	(397.8)	**-**	(7.4)
Non-cash movements on pension		**4.4**	(51.9)	**4.4**	(51.9)
Interest payable in respect of other borrowed funds		**-**	25.4	**-**	25.4
Net credit impairment (gains)/losses		**(5.5)**	1.9	**(5.5)**	1.9
Depreciation, amortisation and impairment of property, plant and equipment and intangibles		**33.5**	39.0	**33.5**	39.0
Other non-cash movements including exchange rate movements		**112.1**	20.1	**112.1**	20.1
Unwind of fair value adjustments arising on transfer of engagements		**-**	60.6	**-**	60.6
Changes in operating assets and liabilities:					
Increase in deposits by banks		**310.8**	102.7	**310.8**	102.7
(Increase)/decrease in prepayments and accrued income		**(7.1)**	4.0	**(7.1)**	4.0
Decrease in accruals and deferred income		**(17.0)**	(35.3)	**(17.0)**	(35.3)
Decrease in customer accounts		**(1,899.2)**	(1,801.9)	**(1,899.2)**	(1,801.8)
Decrease in debt securities in issue and borrowed funds		**(9.8)**	(1,056.9)	**(9.8)**	(1,056.9)
Decrease in loans and advances to banks		**1.8**	102.7	**1.8**	102.7
(Increase)/decrease in loans and advances to customers		**(998.7)**	2,680.7	**(998.7)**	2,680.7
Net movement of other assets and other liabilities		**(58.9)**	28.1	**(58.9)**	28.0
Income tax/group relief received		**1.0**	4.0	**1.0**	4.0
Net cash flows used in operating activities		**(2,673.3)**	(58.6)	**(2,673.3)**	(58.6)
Cash flows from investing activities:					
Purchase of tangible and intangible fixed assets		**(24.4)**	(43.1)	**(24.4)**	(43.1)
Purchase of investment securities		**(462.6)**	(408.1)	**(462.6)**	(408.1)
Proceeds from sale of property, plant and equipment		**0.5**	8.5	**0.5**	8.5
Proceeds from sale of equity shares		**2.3**	25.3	**2.3**	25.3
Proceeds from sale and maturity of investment securities		**875.5**	1,528.0	**875.5**	1,528.0
Proceeds from sale of joint venture		**0.7**	-	**0.7**	-
Dividends received		**5.8**	-	**5.8**	-
Net cash flows from investing activities		**397.8**	1,110.6	**397.8**	1,110.6
Cash flows from financing activities:					
Interest paid on other borrowed funds		**-**	(29.3)	**-**	(29.3)
Net cash raised through Restructuring and Recapitalisation		**-**	180.4	**-**	180.4
Net cash flows from financing activities		**-**	151.1	**-**	151.1
Net (decrease)/increase in cash and cash equivalents		**(2,275.5)**	1,203.1	**(2,275.5)**	1,203.1
Cash and cash equivalents at the beginning of the year		**4,469.4**	3,266.3	**4,469.4**	3,266.3
Cash and cash equivalents at the end of the year		**2,193.9**	4,469.4	**2,193.9**	4,469.4
Cash and balances with central banks	12	**1,789.6**	3,994.5	**1,789.6**	3,994.5
Loans and advances to banks	13	**404.3**	474.9	**404.3**	474.9
		2,193.9	4,469.4	**2,193.9**	4,469.4

1. In accordance with the transitional provisions in IFRS 9, comparative figures have not been restated. See note 36 to the consolidated financial statements for details of changes in accounting policy.

Reconciliation of movements of liabilities to cash flows arising from financing activities

	Group and Bank
	Other borrowed funds
Balance at 1 January 2017	472.6
Changes from financing cash flows	
Interest paid on other borrowed funds	(29.3)
Total changes from financing cash flows	(29.3)
Other changes	
Debt restructuring as part of capital raise	(468.7)
Interest payable on other borrowed funds	25.4
Balance at 31 December 2017	-

More information regarding the basis of preparation can be found in note 1 to the consolidated financial statements.

The notes on pages 121 to 182 form part of these financial statements.

Consolidated statement of changes in equity
For the year ended 31 December 2018
£millions

	Attributable to equity holders of the Group									
2018	**Share capital**	**Share premium**	**Available-for-sale reserve**	**FVOCI reserve**	**Cash flow hedging reserve**	**Capital redemption reserve**	**Capital re-organisation reserve**	**Defined benefit pension reserve**	**Retained earnings**	**Total equity**
At the beginning of the year	0.9	313.8	25.1	-	29.9	410.0	1,737.5	70.8	(1,082.4)	**1,505.6**
IFRS 9 opening balance adjustments	-	-	(25.1)	18.4	-	-	-	-	(10.4)	**(17.1)**
At the beginning of the year adjusted for IFRS 9	**0.9**	**313.8**	**-**	**18.4**	**29.9**	**410.0**	**1,737.5**	**70.8**	**(1,092.8)**	**1,488.5**
Total comprehensive (expense)/income for the year	-	-	-	(4.5)	(9.9)	-	-	344.7	(68.7)	**261.6**
At the end of the year	**0.9**	**313.8**	**-**	**13.9**	**20.0**	**410.0**	**1,737.5**	**415.5**	**(1,161.5)**	**1,750.1**

	Attributable to equity holders of the Bank								
2018	**Share capital**	**Share premium**	**Available-for-sale reserve**	**FVOCI reserve**	**Cash flow hedging reserve**	**Capital redemption reserve**	**Defined benefit pension reserve**	**Retained earnings**	**Total equity**
At the beginning of the year	25.6	2,416.9	25.1	-	29.9	410.0	70.8	(1,472.8)	**1,505.5**
IFRS 9 opening balance adjustments	-	-	(25.1)	18.4	-	-	-	(10.4)	**(17.1)**
At the beginning of the year adjusted for IFRS 9	**25.6**	**2,416.9**	**-**	**18.4**	**29.9**	**410.0**	**70.8**	**(1,483.2)**	**1,488.4**
Total comprehensive (expense)/income for the year	-	-	-	(4.5)	(9.9)	-	344.7	(68.7)	**261.6**
At the end of the year	**25.6**	**2,416.9**	**-**	**13.9**	**20.0**	**410.0**	**415.5**	**(1,551.9)**	**1,750.0**

	Attributable to equity holders of the Group								
2017[1]	Share capital	Share premium	Available-for-sale reserve	Cash flow hedging reserve	Capital redemption reserve	Capital re-organisation reserve	Defined benefit pension reserve	Retained earnings	Total equity
At the beginning of the year	22.6	1,736.9	38.2	56.4	410.0	-	9.5	(1,315.1)	958.5
Total comprehensive (expense)/income for the year	-	-	(13.1)	(26.5)	-	-	61.3	232.7	254.4
Issuance of share capital and Group restructure	(21.7)	(1,423.1)	-	-	-	1,737.5	-	-	292.7
At the end of the year[1]	0.9	313.8	25.1	29.9	410.0	1,737.5	70.8	(1,082.4)	1,505.6

	Attributable to equity holders of the Bank							
2017[1]	Share capital	Share premium	Available-for-sale reserve	Cash flow hedging reserve	Capital redemption reserve	Defined benefit pension reserve	Retained earnings	Total equity
At the beginning of the year	22.6	1,736.9	38.2	56.4	410.0	9.5	(1,315.1)	958.5
Total comprehensive (expense)/ income for the year	-	-	(13.1)	(26.5)	-	61.3	(157.7)	(136.0)
Issuance of share capital	3.0	680.0	-	-	-	-	-	683.0
At the end of the year[1]	25.6	2,416.9	25.1	29.9	410.0	70.8	(1,472.8)	1,505.5

1. In accordance with the transitional provisions in IFRS 9, comparative figures have not been restated. See note 36 to the consolidated financial statements for details of changes in accounting policy.

The results above are for the consolidated Group and consolidated Bank. More information regarding the basis of preparation can be found in note 1 to the consolidated financial statements.

The notes on pages 121 to 182 form part of these financial statements.

1. Basis of preparation and significant accounting policies

The accounting policies referred to as applicable to the Group are equally applicable to the Bank.

1.1 Basis of preparation

The Co-operative Bank Holdings Limited (Holding Company) is incorporated in the UK and registered in England and Wales. On 1 September 2017, the Holding Company became the new Holding Company for The Co-operative Bank plc (Company) and its subsidiaries (Bank) by way of a share-for-share exchange. On the basis that the transaction was effected by creating a new parent that is itself not a business, the transaction was considered to be outside the scope of IFRS 3 (Business Combinations). It was accounted for using the pooling of interest method as a continuation of the existing group. The comparative results for the Group comprise the results of the Bank from 1 January 2017 to 31 August 2017 and of the Holding Company and its subsidiaries from 1 September 2017 to 31 December 2017.

Consolidated results for the year ended 31 December 2018 for the Bank are also presented. The comparative figures for these results are those of the Bank for the year ended 31 December 2017.

All the notes within these financial statements have been prepared on a Group basis, however they are equally applicable to the Bank. Where differences arise this is explicitly stated.

Each of the Holding Company, Bank Company, Group and Bank financial statements have been prepared and approved by the Directors of the respective companies in accordance with IFRS as issued by the International Accounting Standards Board (IASB), and as adopted by the European Union (EU).

The Holding Company and Bank Company are taking advantage of the exemption in Section 408 of the Companies Act 2006 not to present their individual income statements and related notes that form a part of these approved financial statements.

The financial statements have been prepared under the historical cost convention as modified by the revaluation of fair value through other comprehensive income (FVOCI) and available-for-sale (AFS) financial assets, derivative contracts, investment properties and certain other financial assets and financial liabilities held at fair value through profit or loss (FVTPL). The recognition, measurement and disclosure requirements of IFRS in issue that are endorsed by the EU and are effective at 31 December 2018 are applied to both the Group and the Bank. The financial statements comprise all audited sections of the accounts. Where indicated, the risk management section forms part of the audited accounts.

1.2 Standards and interpretations issued

1.2.1 IFRS 9 (Financial instruments)

IFRS 9 as issued by the IASB in 2014 has been adopted with an effective date of 1 January 2018. The requirements of IFRS 9 were not early adopted in previous periods. The adoption of IFRS 9 resulted in changes in accounting policies and adjustments to the opening reserves in the financial statements.

An election has been made to retain the IAS 39 hedge accounting requirements on 1 January 2018. The new IFRS 7 hedge accounting disclosures, effective from 1 January 2018, have been adopted within these financial statements.

Comparative information has not been restated as permitted by the transitional provisions of IFRS 9. Adjustments to the carrying values of financial instruments at the date of transition to IFRS 9 have been recognised in the opening reserves of 2018. Consequently, for note disclosures, the amendments to IFRS 7 as a result of adoption of IFRS 9 have only been applied to the current year. The comparative disclosures reflect those reported in the 2017 Annual Report and Accounts.

The adoption of IFRS 9 has resulted in changes in accounting policies for recognition and de-recognition, classification and measurement of financial instruments and impairment of financial assets. The adoption of IFRS 9 also significantly amends other standards dealing with financial instruments, including IFRS 7 'Financial Instruments: Disclosures', which have been adopted within these financial statements.

Details of the specific IFRS 9 accounting policies applied in the current year as well as previous IAS 39 accounting policies applied in the comparative year are described in section 1.4 below. Transition disclosures are provided in note 36.

1.2.2 Non material standards, amendments and interpretations adopted on 1 January 2018

The following amendments and interpretations were adopted on 1 January 2018 and did not have a material impact on the financial statements:

- Amendments to IFRS 10 (Consolidated Financial Statements) and IAS 28 (Investments in Associates and Joint Ventures (2014))
- Amendments to IFRS 2 (Share-based Payment)
- Amendments to IAS 40 (Investment Property)
- International Financial Reporting Interpretations Committee (IFRIC) 22 (Foreign Currency Transactions and Advance Consideration)

The following standard was adopted on 1 January 2018 and did not have a material impact on the financial statements:

IFRS 15 (Revenue from contracts with customers)
IFRS 15 which was adopted on 1 January 2018 is the new revenue standard, superseding the previous revenue recognition standard (IAS 18) and construction contracts standard (IAS 11). IFRS 15 provides a principles-based approach for revenue recognition, and introduces the concept of recognising revenue for obligations as they are satisfied. The modified retrospective adoption approach to application was applied with no restatement of comparatives, whereby IFRS 15 is applied to new and existing contracts (that have not completed) from 1 January 2018. The majority of the revenue is in the form of interest income from financial instruments, which is not in scope for IFRS 15. Fees and commissions together with certain elements of other non-interest income do fall within the scope of the standard. In nearly all cases the current accounting policy is consistent with the requirements of IFRS 15, accordingly there is no material impact to the timing of revenue recognition. The new IFRS 15 accounting policy is set out in 1.4.2 b) below.

1.2.3 Standards and interpretations issued but not yet effective
At the date of authorisation of these financial statements, the following new and revised IFRSs that have been issued but are not yet effective and in some cases, not yet adopted by the EU, have not been applied:

- **IFRS 16 (Leases)**
  The IASB has published a new standard, IFRS 16 (Leases). The new standard brings most leases on-balance sheet for lessees under a single model, eliminating the distinction between operating and finance leases. Lessor accounting however remains largely unchanged and the distinction between operating and finance leases is retained.

  IFRS 16 supersedes IAS 17 (Leases) and related interpretations and is effective for periods beginning on or after 1 January 2019, with earlier adoption permitted if IFRS 15 (Revenue from Contracts with Customers) has also been applied. IFRS 16 was adopted on 1 January 2019 and the modified retrospective approach was applied to transition. Under the modified retrospective approach, a lessee does not restate comparative figures; instead the cumulative effect of initially applying IFRS 16 is recognised as an opening adjustment to retained earnings. IFRS 16 is estimated to increase total assets by approximately £73.6m, increase total liabilities by £73.6m and to have no impact on shareholders' equity. The main lease category impacted by IFRS 16 is that of property leases.

- **IFRIC 23 (Uncertainty over Income Tax Treatments)**
  The interpretation is to be applied to the determination of taxable profit (tax loss), tax bases, unused tax losses, unused tax credits and tax rates, when there is uncertainty over income tax treatments under IAS 12 (Income Taxes).

  IFRIC 23 was formally endorsed in October 2018. The amendments are effective for reporting periods beginning on or after 1 January 2019 with earlier adoption permitted. The impact of the amendments has not yet been quantified.

- **Amendments to IFRS 9 (Financial Instruments – Prepayment Features with Negative Compensation)**
  The amendments address concerns about how IFRS 9 Financial Instruments classifies particular prepayable financial assets. The amendments to IFRS 9 clarify that a financial asset passes the IFRS 9 Solely Payments of Principal and Interest criteria regardless of the event or circumstance that causes the early termination of the contract and irrespective of which party pays or receives reasonable compensation for the early termination of the contract.

  In addition, the IASB has also clarified an aspect of the accounting for financial liabilities following a modification that an entity recognises any adjustment to the amortised cost of the financial liability arising from a modification or exchange in profit or loss at the date of the modification or exchange. A retrospective change of the accounting treatment may therefore become necessary if in the past the effective interest rate was adjusted and not the amortised cost amount.

  The amendments are effective for reporting periods beginning on or after 1 January 2019. The Group does not foresee any material impact arising from the amendments.

- **Amendments to IAS 28 (Investments in Associates and Joint Ventures)**
  The amendments will eliminate ambiguity in the wording of the standard. The amendments clarify that an entity applies IFRS 9 Financial Instruments to long-term interests in an associate or joint venture that form part of the net investment in the associate or joint venture but to which the equity method is not applied. The amendments are effective for reporting periods beginning on or after 1 January 2019. The Group does not foresee any material impact arising from the amendments.

- **Amendments to IAS 12 (Income Taxes)**
  The amendments clarify the requirements to recognise the income tax consequences of dividends where the transactions or events that generated distributable profits are recognized. This applies to all income tax consequences of dividends. The amendments are effective for reporting periods beginning on or after 1 January 2019. The Group does not foresee any material impact arising from the amendments.

- **Amendments to IAS 23 (Borrowing costs)**
  The amendments clarify that if any specific borrowing remains outstanding after the related asset is ready for its intended use or sale, that borrowing becomes part of the funds that an entity borrows generally when calculating the capitalisation rate on general borrowings. The amendments are effective for reporting periods beginning on or after 1 January 2019. The Group does not foresee any material impact arising from the amendments.

- **Amendments to IAS 19 (Employee Benefits)**
  The amendments clarify that if a plan amendment, curtailment or settlement occurs, it is now mandatory that the current service cost and the net interest for the period after the remeasurement, are determined using the assumptions used for the remeasurement. In addition, they clarify the effect of a plan amendment, curtailment or settlement on the requirements regarding the asset ceiling. The amendments are effective for reporting periods beginning on or after 1 January 2019. The Group does not foresee any material impact arising from the amendments.

- **Amendment to IFRS 3 (Business Combinations) and IFRS 11 (Joint Arrangements)**
  The amendments to IFRS 3 clarify that when an entity obtains control of a business that is a joint operation, it remeasures previously held interests in that business. The amendments to IFRS 11 clarify that when an entity obtains joint control of a business that is a joint operation, the entity does not remeasure previously held interests in that business. The amendments are effective for reporting periods beginning on or after 1 January 2019. The Group does not foresee any material impact arising from the amendments.

- **IFRS 17 (Insurance Contracts)**
  The IASB has published a new standard, IFRS 17 (Insurance Contracts). The new standard requires insurance liabilities to be measured at a current fulfillment value and provides a more uniform measurement and presentation approach for all insurance contracts. The standard is effective for reporting periods beginning on or after 1 January 2021 but has been tentatively deferred to annual periods beginning on or after 1 January 2022, and is not yet endorsed by the EU. The impact of the new standard has not yet been quantified.

Other standards and interpretations have been issued but these are not considered to be relevant to underlying operations. The intention is to comply with the standards from the date they become effective.

1.3 Going concern
IAS 1 (Presentation of Financial Statements) requires Directors to make an assessment of a company's ability to adopt the going concern basis of accounting in the future. IAS 1 states that the information should cover at least 12 months from the end of the reporting period but not be limited to that period. Financial Reporting Council (FRC) guidelines state that the information should consider a period of at least 12 months from the date the financial statements are authorised for issue. This assessment is required at both Group and Bank.

When considering the going concern status of the Group and the Bank, the Directors have referenced the FRC published guidance on the going concern Basis of Accounting and Reporting on Solvency and Liquidity Risks (the 2016 Guidance). The 2016 Guidance is specifically intended for Directors of companies that do not apply the UK Corporate Governance Code. The 2016 Guidance brings together the requirements of company law, accounting standards, auditing standards, other regulation and existing FRC guidance relating to reporting on the going concern basis of accounting and solvency and liquidity risks. It provides application guidance in addition to including principles for best practice and practical examples.

The Group has recently approved its strategic plan for 2019-2023 and has used this as the basis of its assessment in evaluating whether adopting the going concern basis of accounting is appropriate. This includes a detailed review of projected profitability, forecast liquidity position, capital adequacy ratios, regulatory capital considerations and a review of some of the risks the Group faces, including potential mitigating actions. Appropriate consideration has also been given to 2018 performance relative to 2018 expectations and the trajectory into 2019 projections relative to the 2018 exit position.

After considering the matters above, as well as the principal risks and uncertainties (see risk management section 1.6), the Directors have a reasonable expectation that both the Group and the Bank will continue in operational existence for at least the next 12 months. Accordingly, the results for the year ended 31 December 2018 have been prepared on a going concern basis.

1.4 Significant accounting policies
The accounting policies set out below have been applied consistently to all periods, inclusive of assets recognised where the Group and the Bank is subject to the substantial risks and rewards of those assets.

1.4.1 Basis of consolidation
a) Subsidiaries
Subsidiaries are all entities (including structured entities) controlled by the Holding Company or Bank Company. Control exists whenever the Holding Company or Bank Company is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity, in accordance with the requirements of IFRS 10 (Consolidated Financial Statements). In assessing control, potential voting rights that presently are exercisable are taken into account. The financial information of subsidiaries is included in the consolidated financial information from the date that control commences until the date that control ceases.

The financial information has been prepared using consistent accounting policies and applied at the reporting date of the Group and Bank. Intra-group balances and transactions, and any unrealised gains and losses arising from intra-group transactions, are eliminated in preparing the consolidated financial information.

Special Purpose Entities (SPEs) are entities that are created to accomplish a narrow and well defined objective; such entities include:
- SPEs established to facilitate securitisation transactions in which mortgages are sold by Bank Company to an SPE (the equity of these SPEs is not owned by the Bank Company); and
- covered bond Limited Liability Partnership created in order to act as a guarantor for the issue of covered bonds.

The following circumstances may indicate a relationship in which, in substance, the Holding Company or Bank Company controls and consequently consolidates an SPE:

- the activities of the SPE are being conducted on behalf of the Holding Company or Bank Company according to its specific business needs so that benefits are obtained from the SPE's operation;
- the Holding Company or Bank Company has the decision making powers to obtain the majority of the benefits of the activities of the SPE;
- the Holding Company or Bank Company has the rights to obtain the majority of the benefits of the SPE and therefore may be exposed to the risks incidental to the activities of the SPE; or
- the Holding Company or Bank Company retains the majority of the residual or ownership risks related to the SPE or its assets in order to obtain benefits from its activities.

The assessment of whether there is control over an SPE is carried out at inception. A reassessment of whether there is control over an SPE is performed at the end of each year.

b) Interests in joint ventures

A joint venture is a joint arrangement whereby the parties that have joint control of the arrangement have rights to the net assets of the arrangement.

Interests in joint ventures are accounted for using the equity method. The consolidated financial information includes the proportionate share of the income and expenses and equity movements of equity accounted investees, after adjustments to align the accounting policies.

c) Interests in unconsolidated structured entities

Unconsolidated structured entities are unconsolidated entities that have been designed so that voting or similar rights are not the dominant factor in deciding who controls the entity. Structured entities are not consolidated where it is determined with due regard to the variable returns from the structured entity and the ability to affect those returns, that the structured entity is not controlled under IFRS 10 (Consolidated Financial Statements) considerations. The Group acts as a sponsor for certain unconsolidated securitisation vehicle holding companies which it neither owns nor controls. The Group has determined itself a sponsor of unconsolidated securitisation vehicle companies if it does not have a material ongoing interest in the entity, but it may act to protect its reputation in relation to the structured entity.

1.4.2 Revenue recognition

a) Interest income and expense

The Effective Interest Rate (EIR) basis spreads the interest income and expense over the expected life of each instrument. The EIR is the rate that, at the inception of the instrument, exactly discounts expected future cash payments and receipts through the expected life of the instrument back to the initial carrying amount. When calculating the EIR, the Group estimates cash flows considering all contractual terms of the instrument (for example, prepayment options) but does not consider assets' future credit losses except for assets acquired at a deep discount. The EIR basis is inclusive of directly attributable origination and incremental transaction costs and fees including arrangement and broker fees, valuation and solicitor costs, discounts and premiums where appropriate. Early redemption charges are recognised on a cash basis as received, as it is not possible to reliably estimate the receipt of such fees.

When the Group revises the estimates of future cash flows, the carrying amount of the respective financial asset or liability is adjusted to reflect the new estimate discounted at the original EIR of the instrument, and continues unwinding the discount as interest income in profit or loss.

Application under IFRS 9

Interest income and expense is recognised on an EIR basis except for:

- Purchased or originated credit impaired assets, for which the original credit-adjusted effective interest rate is applied to the amortised cost of the financial asset; and
- Financial assets which are not purchased or originated credit impaired assets but have become credit-impaired (reside within stage 3), for which interest income is calculated by applying the EIR to their amortised cost (i.e. net of the expected credit loss provision).

Application under IAS 39

Interest income and expense is recognised on an EIR basis except for assets acquired at a deep discount. The calculation of EIR is based on future cash flows which include incurred credit losses.

When an instrument is impaired, the carrying amount is reduced based on the revised cash flows, discounted at the original EIR of the instrument, and continues unwinding the discount as interest income.

b) Fees and commissions

IFRS 15 accounting policy

Fee and commission income is predominantly made up of arrangement and other fees relating to loans and advances to customers that are included in the EIR calculation. Commitment fees received are deferred and included in the EIR calculation upon completion or taken in full at the date the commitment period expires and completion does not occur.

All other fee and commission income, such as loan closure fees or arrears fees, administration and other charges, current account and payments fees and charges, not included in the EIR calculation, are recognised on a point-in-time basis as the performance obligation is satisfied at the time the fees are charged. There are no future performance obligations or variable considerations involved per the contracts.

The Group enters into contracts with customers on behalf of certain entities (Co-operative Group and Legal and General Group plc) to provide funeral care services and insurance. The Group acts as an agent in all such circumstances and does not control the services provided by the entities. The Group satisfies its performance obligation at the time when the contract is sold and recognises its commission, the net amount of consideration that it retains after paying the consideration received in exchange for the services to be provided by the entities.

The Group offers cash back incentives on certain credit card arrangements and treats them as an expense. These arrangements do not provide customers with a separate performance obligation or a material/significant right in advance, or constitute part of a contract.

Fees and commissions payable to brokers in respect of obtaining lending business, where these are direct and incremental costs related to the issue of a financial instrument, are included in interest income as part of the effective interest rate.

IAS 18 accounting policy (where different to IFRS 15)

All other fee and commission income, such as loan closure fees or arrears fees, ATM fees and charges, current account and payments fees and charges, not included in the EIR calculation, are recognised on an accruals basis as the service is provided.

c) Dividend income

IAS 39 and IFRS 9 accounting policy

Dividend income is recognised when the right to receive the payment is established, which is generally when the Directors approve the dividend as final. Interim dividends are recognised in the income statement when the dividend is paid.

1.4.3 Financial instruments (excluding derivatives)

a) Recognition

IAS 39 and IFRS 9 accounting policy

Financial assets and financial liabilities are recognised in the balance sheet when the Group becomes party to the contractual provisions of the instrument. Loans and advances are initially recognised when they are advanced to customers. Deposits, debt securities issued and other borrowed funds are recognised on the date at which they are originated. Regular way purchases and sales of financial assets are recognised on the trade date at which the commitment to purchase or sell the asset is made.

b) Classification and measurement of financial assets

IFRS 9 accounting policy

i. Overview

Financial assets (excluding derivatives) are classified as:

- Amortised cost;
- Fair value through other comprehensive income; or
- Fair value through profit or loss.

ii. Debt instruments

Debt instruments are initially measured at fair value plus transaction costs that are directly attributable to the financial asset. The fair value valuation techniques are discussed in note 33. Unless designated at FVTPL, the classification and subsequent measurement of debt instruments is based on:

- The business model for managing the debt instruments; and
- The contractual cash flows of the debt instruments.

IFRS 9 financial asset classification category	Classification criteria	Subsequent measurement
Amortised cost	The business model objective in which the debt instrument is held is hold to collect the contractual cash flows, and the contractual cash flows of the debt instrument are solely payments of principal and interest.	Amortised cost financial assets are subsequently measured at the amount at which the financial asset was measured at initial recognition, less principal repayments, plus or minus the cumulative amortisation using the effective interest method of the difference between that initial amount and the maturity amount and adjusted for any loss allowance.
Fair value through other comprehensive income	The business model objective in which the debt instrument is held is hold to collect the contractual cash flows and sell, and the contractual cash flows of the debt instrument are solely payments of principal and interest.	Fair value through other comprehensive income financial assets are subsequently measured at fair value, with movements in fair value being recognised in other comprehensive income, except for the recognition of impairment gains and losses, interest income and foreign exchange gains and losses on the debt instrument's amortised cost, which are recognised in the income statement. When the debt instrument is derecognised, cumulative gains and losses previously recorded in other comprehensive income are reclassified from equity to the income statement and recognised in other operating (expense)/income (net). Interest income from debt instruments classified at fair value through other comprehensive income is measured using the effective interest rate method.
Financial assets at fair value through profit or loss	Debt instruments which are not classified at amortised cost or fair value through other comprehensive income. Debt assets may also be irrevocably designated at FVTPL if doing so significantly reduces or eliminates a mismatch created by assets and liabilities being measured on different bases.	Financial assets at fair value through profit or loss are subsequently measured at fair value. The fair value gains and losses for those debt instruments which have not been designated with a hedge accounting relationship are recognised within the income statement for the year and recorded within other operating (expense)/income (net). The fair value gains and losses for those debt instruments which have been designated with a hedge accounting relationship are recognised within the income statement for the year and recorded within other operating (expense)/income (net). Interest income from debt instruments classified at fair value through profit or loss is measured using the effective interest rate method.

The business model for managing the debt instruments

The IFRS 9 business models reflect how financial assets are managed in order to generate cash flows. The business model determines whether cash flows will result from collecting contractual cash flows, selling financial assets or both. Factors considered in determining the business model for a group of assets include both past experience and future plans for these assets. The IFRS 9 business models (which are distinct from the definition under IFRS 8 operating segments) were determined with reference to how the asset's performance is evaluated and reported to key management personnel, how risks are assessed and managed and how key management is compensated.

The contractual cash flows of the debt instruments

In determining the classification of a financial asset, the Group determines whether the financial asset's cash flows represent solely payments of principal and interest (the 'SPPI test'). Payments of principal and interest are solely those consistent with a basic lending arrangement i.e. interest includes only consideration for the time value of money, credit risk, other basic lending risk (including liquidity risk), costs (including administrative costs) and a profit margin that is consistent with a basic lending arrangement. If the SPPI test is not passed, then the related financial asset is measured at fair value through profit or loss. Financial assets with embedded derivatives are considered in their entirety when determining whether their cash flows are solely payments of principal and interest.

Debt instruments are only reclassified when the business model for managing such assets is changed. Such changes as a result of external or internal changes must be significant, demonstrable to external parties, and are expected to be rare in occurrence.

iii. Equity instruments

Equity instruments are those instruments which meet the definition of equity from the issuer's perspective. Such instruments do not contain a contractual payment obligation and evidence a residual interest in the issuer's net assets.

Equity instruments are initially measured at fair value based on current bid prices where quoted in an active market. Where equity instruments are unlisted, the fair values are based on valuation techniques including discounted cash flow analysis, with reference to relevant market rates, and other commonly used valuation techniques. The fair value valuation techniques are discussed in more detail in note 33.

All equity instruments are measured at FVTPL unless an election is made to irrevocably designate, on an instrument by instrument basis, at FVOCI. When this election is applied, cumulative gains and losses are recognised in other comprehensive income but are not transferred to profit or loss on de-recognition of the equity instrument.

Gains and losses on equity instruments at FVTPL are recognised within other operating (expense)/income (net) in the income statement.

IAS 39 accounting policy
i. Overview
Financial assets (excluding derivatives) are classified as:
- loans and receivables;
- available-for-sale; or
- financial assets at fair value through profit or loss.

ii. Loans and receivables
Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market and there is no intention to sell immediately or in the near term. These are initially measured at fair value plus transaction costs that are directly attributable to the financial asset. Subsequently, these are measured at amortised cost using the EIR method. The amortised cost is the amount advanced less principal repayments, plus the cumulative amortisation using the EIR method of any difference between the amount advanced and the maturity amount less impairment provisions for incurred losses.

Loans and receivables mainly comprise loans and advances to banks and customers (except where the election to carry the loans and advances to customers at fair value through profit or loss, as described in accounting policy, 1.4.3 b) iv, below is made).

There are a number of facility agreements with multiple counterparties, which form a single contractual relationship. These arrangements are considered to be single financial instruments and accounted for accordingly within loans and advances to customers, or customer deposits respectively.

Loans and receivables include RMBS measured at amortised cost, being a 5% regulatory holding of the Warwick Finance Three unconsolidated structured entity.

iii. Available-for-sale
Available-for-sale financial assets are debt securities and equity shares quoted in an active market and not accounted for at fair value through profit or loss. These are initially recognised on their trade date, measured at fair value based on current bid prices where quoted in an active market. Where the debt securities and equity shares are unlisted the fair values are based on valuation techniques including discounted cash flow analysis, with reference to relevant market rates, and other commonly used valuation techniques. Movements in fair value are recorded in equity as they occur. On disposal, gains and losses recognised previously in equity are transferred to the income statement.

Available-for-sale financial assets include RMBS representing the interest in unconsolidated structured entities.

iv. Financial assets at fair value through profit or loss
Financial assets designated at fair value are assets which have been designated to eliminate or significantly reduce a measurement inconsistency or where management specifically manages an asset or liability on that basis, e.g. corporate loans to customers.

These assets are measured at fair value based on current bid prices where quoted in an active market. Where there is no active market or the securities are unlisted the fair values are based on valuation techniques including discounted cash flow analysis, with reference to relevant market rates, and other commonly used valuation techniques. Gains and losses arising from changes in the fair value are brought into the income statement within other operating income as they arise.

c) Impairment of financial assets
IFRS 9 accounting policy
Under IFRS 9, the expected credit loss (ECL) is assessed on a forward-looking basis for debt instruments carried at amortised cost and FVOCI, for exposures related to loan commitments, and for financial guarantee contracts. Under IFRS 9, a loss allowance for such losses is recognised, reflecting:
- an unbiased and probability weighted amount that was determined by evaluating a range of possible outcomes;
- the time value of money; and
- reasonable and supportable information that was available without undue cost or effort at the reporting date about past events, current conditions and forecasts of economic data.

Credit risk is measured using probability of default (PD), the exposure at default (EAD) and loss given default (LGD) (please refer to the glossary for definitions).

The IFRS 9 3 stage approach to model ECL is applied:

Stage 1 Initial recognition	Stage 2 Significant increase in credit risk	Stage 3 Credit impaired
12 month ECL	Lifetime ECL	

Financial instruments are classified within stage 1 on initial recognition. If a significant increase in credit risk (SICR) since recognition is identified but the financial instrument is not credit impaired, then the financial instrument transitions to stage 2. A financial instrument transitions to stage 3 when it becomes credit impaired.

Financial instruments within stage 1 have a loss allowance reflecting a 12 month ECL whereas financial instruments within stage 2 and 3 have a loss allowance reflecting a lifetime ECL. Financial instruments which are purchased or originated credit impaired (POCI) attract a lifetime ECL until de-recognition irrespective of staging criteria. For stage 3 assets, interest is recorded on a net basis.

i. Constitution of the expected credit loss provision

The ECL provision is calculated based on collective and individual assessments. Post model adjustments (expert overlays) are applied to reflect risk characteristics for assets subject to collective provisioning but for which a specific risk characteristic is not captured within the collective models.

ii. Significant increase in credit risk

A financial instrument is considered to have experienced a significant increase in credit risk since initial recognition when one or more quantitative or qualitative or backstop criteria have been met. The quantitative criterion is a PD based measure, with a backstop of 30 days past due. Qualitative drivers of a significant increase in credit risk include exposures determined to be higher risk and subject to closer credit risk monitoring.

The 'low credit risk exemption' available within IFRS 9 applies to certain highly rated treasury assets. Accordingly, at each balance sheet date, it is assumed that credit risk on all such financial assets has not increased significantly since initial recognition. The 'low credit risk exemption' has not been applied to any other type of financial asset.

iii. Definition of default and credit impaired financial instruments

Portfolio	Quantitative criteria	Qualitative criteria
Retail secured and Optimum	180 days past due	Bankrupt and 30 days overdue Fraud Litigation/possession Term expiry Certain types of forbearance and unlikeliness to pay factors
Retail unsecured	90 days past due	Bankruptcy Certain types of forbearance and unlikeliness to pay factors
Corporate	90 days past due	Insolvency Certain types of forbearance and unlikeliness to pay factors
Treasury	90 days past due	Insolvency

The criteria above are aligned with the definition of default used for credit risk management practices and for regulatory capital reporting purposes. The default definition is applied consistently throughout the ECL calculation within the PD, LGD and EAD models.

The presumption within IFRS 9 that Retail secured and Optimum loans which are more than 90 days past due are allocated to stage 3 has been rebutted and a quantitative backstop of 180 days past due has been applied. 180 days past due is considered a more appropriate criterion for determining default as 180 days past due is used internally for internal credit risk management and regulatory purposes. Analysis has been performed which shows that 180 days past due is a more appropriate default definition for the Retail secured portfolio.

If an instrument does not meet the default criteria for a defined period of months (after a probationary period of 6-12 months) then an instrument is no longer considered in default. This period has been set with regard to the probability of an instrument returning to default status after cure.

iv. Calculation of the ECL

The ECL is calculated as the discounted multiple of PD, EAD and LGD, which are all based on historical analysis, adjusted for the future view of forward-looking macroeconomic information. EAD model estimates for the undrawn commitments on revolving facilities are based on historical customer behavior on those products. See v. below for an explanation of how forward-looking information is included in ECL calculations.

The lifetime ECL is calculated by projecting the PD, EAD and LGD for each future quarter and for each individual exposure or collective segment, adjusted for the likelihood of default in earlier quarters, discounted back to the reporting date. The 12 month ECL is calculated in the same way as the lifetime ECL, with the exception that the calculation only includes losses from default events occurring in the 12 months following the balance sheet date. The discount rate applied is the EIR.

v. Incorporation of forward-looking information

Both the assessment for SICR and the calculation of ECL incorporate forward-looking information. Historical analysis has been performed to identify the key economic variables impacting credit risk and expected credit losses by portfolio. Regression analysis was performed to determine which economic variables are key to individual portfolios. Forecasts of key economic variables reflecting the economic scenarios are provided by an internal economics team on a regular basis. At 1 January 2018 the economics team sourced economic scenarios from a third party and made adjustments as necessary prior to approval via internal governance processes. During 2018, the economics team switched to building economic scenarios in-house which are approved via internal governance processes.

In order to capture non linearities and asymmetries within the ECL calculation, a number of possible scenarios, together with their weightings, are obtained from the internal economics team. The number of scenarios and their weightings are assessed on an annual basis (subject to any interim salient economic events). By considering statistical analysis and applying expert credit judgement, it has been determined that two upside and two downside scenarios in addition to the base scenario are required (one upside and one downside scenario in addition to the base scenario were applied as at 1 January 2018).

The assessment of SICR is performed using the remaining lifetime PD under each scenario, multiplied by the scenario weighting, along with the qualitative and backstop indicators set out in ii) above. This assessment determines whether the whole financial instrument should be in stage 1, 2 or 3 and hence whether a 12 month or a lifetime expected credit loss should be recognised. Following this assessment the ECL is measured as either a probability weighted 12 month ECL (stage 1) or a probability weighted lifetime ECL (stage 2 or 3). The probability weighted ECLs are calculated by applying each scenario to the ECL models and multiplying the result by the respective scenario weighting.

vi. Segmentation of portfolios
Financial assets are grouped together where ECL calculations are performed on a collective basis. Regression analysis has been performed to determine how financial assets should be grouped such that risk characteristics of assets within a group are homogeneous and the risk characteristics of each group are statistically significant to another.

vii. Recognition of the ECL provision and write off policy
The amount of the impairment loss on financial assets measured at amortised cost and FVOCI is recognised immediately through the income statement and a corresponding reduction in the value of the financial asset is recognised through the use of an allowance account.

A write off is made when all or part of a claim is deemed uncollectable or forgiven after all the possible collection procedures have been completed and the amount of loss has been determined. Write offs are charged against previously established provisions for impairment or directly to the income statement.

Any additional recoveries from borrowers, counterparties or other third parties made in future periods are offset against the write off charge in the income statement once they are received.

Provisions related to backwards transitions are released in accordance with the ECL provisioning methodology set out above in 1.4.3 c) i.-iv.

IAS 39 accounting policy

Assessment
i. Objective evidence
At the balance sheet date, an assessment is made as to whether there is objective evidence that a financial asset or group of financial assets, not held at FVTPL, is impaired. Impairment losses are incurred only if there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition and before the balance sheet date (a 'loss event') which has an impact on the estimated future cash flows of the financial asset that can be reliably estimated.

Objective evidence that financial assets are impaired can include significant financial difficulty of the borrower, a breach of contract, such as default or delinquency in interest or principal payments, the granting to the borrower, for economic and legal reasons relating to the borrower's financial difficulty, a concession that would not otherwise be considered, indications that a borrower or issuer will enter bankruptcy or other financial re-organisation, or the disappearance of an active market for a security.

Evidence for impairment for loans and advances is considered at both a specific asset and collective level.

ii. Forbearance
A policy of forbearance is operated which mitigates against borrower default. All such cases are included within provisioning methodology.

Residential secured mortgages
Loans under forbearance are categorised as impaired and collectively assessed for impairment.

Unsecured Retail business
Irrespective of forbearance, impairment is charged in accordance with the identified past due and unidentified loss event approaches described in the risk management section.

Corporate business
Accounts subject to forbearance which are in default are individually assessed for impairment. Loans under forbearance and on the watchlist are categorised as impaired and collectively assessed for impairment.

For further information on the approach to forbearance, its management and execution, see the risk management section.

Scope
i. Individual accounts
All secured loans and advances are assessed for impairment using a range of criteria graded for levels of risk. Accounts at risk of impairment are monitored and impaired where they display clear indicators of underperformance.

All Corporate loans in default are individually assessed for impairment.

Loans and advances that do not meet the criteria for individual impairment, or which do but are not found to be impaired, are collectively assessed for impairment (incurred but not yet reported) by grouping together loans and advances with similar risk characteristics.

ii. Collective accounts

a) Retail

When assessing collective impairment for secured Retail loans, a shortfall is estimated based on the difference between the current loan balance and the expected 'forced sale' price of collateral, discounted at the effective interest rate of the loan to reflect the anticipated time to sale, and taking into account anticipated fees and costs prior to sale. The shortfall is multiplied by the probability the loan will default and further multiplied by the probability that the loan will be taken into possession to determine the impairment required.

When assessing collective impairment for unsecured Retail loans, losses on loans are estimated via a two stage approach, which determines probability of default (PD) and loss given default (LGD) to generate provision rates which are applied to the current balance sheet, including loans transferred to debt collection agencies. Once impaired, accounts are subjected to higher levels of impairment according to both their relevant stage of delinquency, i.e. the number of days in arrears, and their consequent likelihood of ultimately being charged off. Default rates, loss rates and future recoveries are regularly benchmarked against actual outcomes to ensure that they remain appropriate.

Impairment provisions are determined by models and augmented where it feels that direct model outputs do not adequately reflect all risks within a portfolio. Post model adjustments (PMAs) can be determined where:

- there is inaccurate or missing data;
- there is evidence of a loss event but comprehensive data does not exist; and/or
- one-time events, such as changes to processes or Control Standards, which have yet to be reflected in modelled outputs.

Impairment determined both via provision models and post model adjustments is monitored and reviewed by the senior management team on an ongoing basis.

b) Corporate

Collective provisions are held for all Corporate exposures, apart from customers in default for which specific provisions have been raised. Collective provisions are determined by multiplying the drawn balance of the loan by the following default estimates:

i) the probability that, during the emergence period, balances will move to default; or

ii) the probability that, during the emergence period, balances will move to impaired; and

iii) the probability that, during the outcome period, balances will move from impaired to default.

The resulting balance is multiplied by the proportion of newly defaulted balances that ultimately move to an unrecoverable LGD.

The loss emergence period is defined as the time between a loss event occurring and it being evidenced. For Corporate loans the emergence period is six months and is reviewed annually. For all commercial real estate loans where the indexed loan-to-value (LTV) is greater than 100% and those loans which are due to contractually expire in the next 36 months and the indexed LTV is greater than 65%, the probability of emerging to impaired (Pe(i)) parameter is set to 100%. All other PD components are based on recently observed loan migration experience. Loans which are on watchlist are impaired and therefore Pe(i) is set to 100%.

c) Measurement

The amount of the loss is the difference between:

- the asset's carrying amount; and
- the present value of estimated future cash flows (discounted at the asset's original EIR for amortised cost assets and at the current market rate for available-for-sale assets).

Where the debt is secured, the assessment reflects the expected cash flows from the realisation of the security, net of cost to realise, whether or not foreclosure or realisation of the collateral is probable.

d) Impairment of financial assets carried at amortised cost

The amount of the impairment loss on assets carried at amortised cost is recognised immediately through the income statement and a corresponding reduction in the value of the financial asset is recognised through the use of an allowance account.

A write off is made when all or part of a claim is deemed uncollectable or forgiven after all the possible collection procedures have been completed and the amount of loss has been determined. Write offs are charged against previously established provisions for impairment or directly to the income statement.

Any additional recoveries from borrowers, counterparties or other third parties made in future periods are offset against the write off charge in the income statement once they are received.

Provisions are released at the point at which it is deemed that, following a subsequent event, the risk of loss has reduced to the extent that a provision is no longer required.

e) Impairment of financial assets classified as available-for-sale
Available-for-sale assets are assessed at each balance sheet date to see whether there is objective evidence of impairment. In such cases, any impairment losses are recognised by transferring the cumulative loss that has been recognised directly in equity to profit or loss.

When a subsequent event causes the amount of impaired loss on available-for-sale investment securities to decrease, and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed through the income statement. However, any further recovery in the fair value of an impaired available-for-sale equity security is recognised directly in equity.

d) Modification of loans
IFRS 9 accounting policy
When renegotiating or otherwise modifying the contractual cash flows of loans to customers e.g. by applying forbearance, the Group considers whether or not the new terms are substantially different to the original terms. The matters considered in determining whether a modification of contractual cash flows substantially changes the original terms includes the following:

- Whether the old loan was fully paid up with a new advance being made in its place;
- Significant changes in term or interest rates as a result of restructure;
- Substitution of collateral that significantly affects the credit risk associated with the loan; and
- For loans subject to forbearance, whether such forbearance measures significantly affect the cash flows which are expected to flow to the Group.

If the new terms are substantially different to the original terms then the Group derecognises the original loan and recognises a new loan, see 1.4.3 e) below.

If the new terms are not substantially different to the original terms, the modification in contractual cash flows does not result in de-recognition. A new gross carrying amount is calculated by discounting the modified cash flows at the original EIR (or the credit adjusted EIR for purchased or originated credit impaired financial instruments). The gain or loss on modification of the contractual cash flow associated with the recognition of the revised gross carrying amount is recognised in the income statement.

For such modifications which have not resulted in de-recognition, the Group considers if such a modification has not already resulted in transition as a result of triggering the qualitative criteria listed above in 1.4.3 c) ii. and iii., whether credit risk has increased significantly since initial recognition or whether credit risk has significantly improved resulting in backwards transition (moving from stage 2 to stage 1, or stage 3 to stage 2 or 1). The modifications which have not resulted in de-recognition which also have not already transitioned backwards from stage 3 or 2 as a result of the qualitative transition criteria are minimal. This is because, for most assets, the qualitative criteria for transition would have already resulted in modified assets moving to stage 2 or 3. The probationary period for backwards transitions are set out above in 1.4.3 c) ii.

e) *De-recognition*
IFRS 9 accounting policy
When the Group renegotiates or otherwise modifies the contractual cash flows of financial assets and the new terms are substantially different to the original terms, the Group derecognises the original asset and recognises a new asset with a re-set date of initial recognition for ECL impairment purposes. For all other assets, the following represent the date of initial recognition for ECL impairment purposes:

- For originated financial instruments, the contractual start date is the date of initial recognition.
- For any financial instruments purchased at fair value from another entity, their date of initial recognition is the date of purchase of the account.
- For acquired subsidiaries, the recognition date of financial instruments will be the date the asset was originally recognised by the subsidiary and not the date the subsidiary was acquired.
- For retail credit cards and corporate charge cards, the recognition and de-recognition dates are re-set based on behavioural lives.
- For treasury assets, the date of initial recognition is the instrument's acquisition trade date.
- De-recognition of retail unsecured loans is modelled in accordance with their respective debt sale agreements.

i. De-recognition of financial assets resulting from a modification of contractual cash flows
When the contractual cash flows of financial assets are renegotiated or otherwise modified and the new terms are substantially different to the original terms, the original asset is derecognised, and a new asset is recognised at fair value with a new EIR. The date from which the modification is effective becomes the date of initial recognition for the calculation of the ECL and whether the asset has incurred a significant increase in credit risk since initial recognition. At the date of recognition of the new asset, an assessment is made as to whether the asset was credit impaired on recognition. The difference between the carrying amount derecognised and that re-recognised is included in the income statement as a gain or loss on de-recognition.

ii. De-recognition of financial assets other than on modification of contractual cash flows
The Group derecognises a financial asset when the contractual rights to the cash flows from the financial assets expire, or it transfers the rights to receive the contractual cash flows in a transaction in which substantially all of the risks and rewards of ownership of the financial asset are transferred. If the Group neither transfers nor retains substantially all the risks and rewards of ownership and continues to control the transferred asset, the Group recognises its retained interest in the asset and an associated liability for amounts it may have to pay.

Transactions are entered into whereby the contractual rights to receive cash flows from assets are retained but with a contractual obligation to pay those cash flows and to transfer substantially all of the risks and rewards to another entity. These transactions are accounted for as 'pass through' transfers that result in de-recognition if:

- There is no obligation to make payments unless equivalent amounts are collected from the assets;
- The sale or pledging of the assets is prohibited; and
- There is an obligation to remit cash collected from the assets to another entity without material delay.

Collateral provided under standard repurchase agreements, securities lending and borrowing transactions is not derecognised because substantially all of the risks and rewards are retained on the basis of the predetermined repurchase price, and the criteria for de-recognition are therefore not met.

Financial assets associated with certain internal securitisation transactions are not derecognised because the Bank Company retains substantially the risks and rewards on the transferred financial assets.

When a financial asset is derecognised in its entirety, the difference between the carrying amount and the sum of the consideration received (including any new asset obtained less any new liability assumed) is recognised in the income statement.

iii. De-recognition of financial liabilities
A financial liability is derecognised when the obligation is discharged, cancelled or expires. Any difference between the carrying amount of a financial liability derecognised and the consideration paid is recognised in the income statement.

IAS 39 accounting policy
A financial asset is derecognised when the contractual rights to the cash flows from the financial assets expire, or it transfers the rights to receive the contractual cash flows in a transaction in which all the risks and rewards of ownership transfer. If neither transfer nor retention of substantially all the risks and rewards of ownership occurs, and control of the transferred asset continues, the retained interest in the asset and an associated liability for amounts it may have to pay is recognised. A substantial modification of the terms of an existing financial liability or a part of it (whether or not attributable to the financial difficulty of the debtor) is accounted for as an extinguishment of the original financial liability and a recognition of a new financial liability.

When a financial asset is derecognised in its entirety, the difference between the carrying amount and the sum of the consideration received (including any new asset obtained less any new liability assumed) is recognised in the income statement.

When available-for-sale financial assets are derecognised, the cumulative gain or loss, including that previously recognised in other comprehensive income, is recognised in the income statement.

A financial liability is derecognised when the obligation is discharged, cancelled or expires. Any difference between the carrying amount of a financial liability derecognised and the consideration paid is recognised through the income statement.

f) Classification and measurement of financial liabilities
IFRS 9 and IAS 39 accounting policy
Financial liabilities are contractual obligations to deliver cash or another financial asset. Financial liabilities are recognised initially at fair value, net of directly attributable transaction costs.

Financial liabilities, other than derivatives, are subsequently measured at amortised cost. Derivative financial liabilities are subsequently remeasured to their fair value at each balance sheet date. The resulting gain or loss is recognised in the income statement immediately unless the derivative is designated and effective as a hedging instrument in a cash flow hedge. See 'Derivative financial instruments and hedge accounting' policy for more detail.

1.4.4 Sale and repurchase agreements
Securities sold subject to repurchase agreements (repos) are reclassified on the balance sheet as pledged assets when the transferee has the right by contract or custom to sell or re-pledge the assets. The liability to the transferee is also included on the balance sheet, in deposits by banks. The difference between sale and repurchase price is accrued over the life of the agreements.

Securities purchased under agreements to re-sell reverse repos are classified as loans and advances to banks on the balance sheet, as appropriate.

1.4.5 Derivative financial instruments and hedge accounting

a) Derivatives used for asset and liability management purposes

Derivatives are used to hedge interest and exchange rate exposures related to non-trading positions. Instruments used for hedging purposes include swaps, forward rate agreements, options and combinations of these instruments.

Derivative financial instruments are stated at fair value using valuation techniques such as discounted cash flow models. Further information is provided in note 16 to the consolidated financial statements. All derivatives are carried as assets when the fair value is positive and liabilities when the fair value is negative. The gain or loss on re-measurement to fair value is recognised immediately in the income statement except where derivatives qualify for cash flow hedge accounting.

Where hedge accounting is applied, the economic relationship between the hedging instrument(s) and hedged item(s) is documented including the risk management objective and strategy in undertaking the hedge transaction together with the method used to assess effectiveness of the hedging relationship.

Also documented is the assessment, both at the inception of the hedge relationship as well as on an ongoing basis, as to whether the hedging instruments are expected to be 'highly effective' in offsetting the changes in fair value or cash flows of the respective hedged items during the period for which the hedge is designated, and whether the actual offset in changes in fair value in each hedge are within a range of 80% to 125%.

i. Cash flow hedges

Where derivatives are designated as hedges of the exposure to variability in cash flows of a recognised asset or liability, or a highly probable forecast transaction, the portion of the fair value gain or loss on the derivative that is determined to be an effective hedge is recognised directly in equity. The ineffective part of any gain or loss is recognised in the income statement immediately.

The accumulated gains and losses recognised in equity are reclassified to the income statement in the periods in which the hedged item will affect profit or loss. When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss recognised at that time remains in equity until the forecast transaction is eventually recognised in the income statement.

When a forecast transaction is no longer expected to occur, the cumulative gain or loss that was recognised in equity is immediately reclassified to the income statement.

ii. Fair value hedges

Where a derivative is designated as the hedging instrument to hedge the change in fair value of a recognised asset or liability or a firm commitment that could affect profit or loss, changes in the value of the derivative are recognised immediately in the income statement together with changes in the fair value of the hedged item that are attributable to the hedged risk. Fair values are based on quoted market prices in active markets or, where these are not available, using valuation techniques such as discounted cash flow models. If the derivative expires or is sold, terminated, or exercised, or no longer meets the criteria for fair value hedge accounting, or the designation is revoked, then hedge accounting is prospectively discontinued. Any adjustment up to that point, to a hedged item for which the EIR method is used, is amortised to profit or loss as part of the recalculated EIR of the item over its remaining life.

iii. Fair value hedge accounting for a portfolio hedge of interest rate risk

As part of the risk management process, portfolios are identified where interest rate risk is to be hedged. The portfolios may comprise only assets, only liabilities or both assets and liabilities. Each portfolio is analysed into repricing time periods based on expected repricing dates, by scheduling cash flows into the periods in which they are expected to occur. Using this analysis, the percentage to hedge is decided and designated as the hedged item is an amount of assets or liabilities from each portfolio equal to this.

The change in fair value of the portfolio relating to the risk that is being hedged is measured monthly. Provided that the hedge has been highly effective, the change in fair value for the hedged risk of each hedged item is recognised in the income statement with the cumulative movement in its value being shown on the balance sheet as a separate item, fair value adjustment for hedged risk, either within assets or liabilities as appropriate. If the hedge no longer meets the criteria for hedge accounting, this amount is amortised to the income statement over the remaining useful life of the hedge item on an appropriate basis.

The fair value of each hedging instrument is measured and this is included in derivative financial instruments in either assets or liabilities as appropriate, with the change in value recorded in the income statement. Any hedge ineffectiveness is recognised in the income statement as the difference between the change in fair value of the hedged item for the hedged risk and the change in fair value of the hedging instrument.

b) Embedded derivatives

IFRS 9 accounting policy

A derivative may be embedded in another liability, known as the host contract. Where the economic characteristics and risks of an embedded derivative are not closely related to those of the host contract (and the host contract is not carried at fair value through profit or loss), the embedded derivative is separated from the host and held on-balance sheet at fair value. Movements in fair value are recognised in the income statement, whilst the host contract is accounted for according to the relevant accounting policy for that particular liability.

Embedded derivatives are not considered in the context of financial assets, with the classification and measurement of the entire instrument instead based on the contractual terms of the financial asset and the related business model.

IAS 39 accounting policy
A derivative may be embedded in another instrument, known as the host contract. Where the economic characteristics and risks of an embedded derivative are not closely related to those of the host contract (and the host contract is not carried at fair value through profit or loss), the embedded derivative is separated from the host and held on-balance sheet at fair value. Movements in fair value are recognised in the income statement, whilst the host contract is accounted for according to the relevant accounting policy for that particular asset or liability.

1.4.6 Property, plant and equipment
Assets are recognised where there is substantial exposure to all the risks and rewards of those assets. Items of property, plant and equipment are stated at cost less any accumulated depreciation and impairment losses. Depreciation is recognised on a straight line basis at the following maximum default rates, which are estimated to reduce the assets to their realisable values at the end of their useful lives.

Long leasehold land and buildings	40 years	Computers and other equipment	5 years
Freehold and leasehold improvements	10 years	Furniture and equipment	10 years
Short leasehold buildings	life of lease		

All items of property, plant and equipment are reviewed for indications of impairment on a regular basis and at each balance sheet date. If impairment is indicated, the asset's recoverable amount (being the greater of fair value less cost to sell and value in use) is estimated. Value in use is calculated by discounting the future cash flows generated from the continuing use of the asset. If the carrying value of the asset is greater than the recoverable amount, the shortfall is recognised in the income statement.

Gains and losses on disposal of an item of property, plant and equipment are determined by comparing the proceeds from disposal, less costs to sell, with the carrying amount and are recognised net within operating expenses in the income statement.

1.4.7 Intangible assets
Intangible assets (including those which are internally generated) are initially recognised when they are separable or arise from contractual or other legal rights, where it is probable that future economic benefits attributable to the assets will flow from their use and the cost can be measured reliably.

The cost of internally generated assets only include employee costs to the extent that they are directly attributable to the development of the identified asset (indirect and general overhead costs are excluded). Internally generated assets are amortised from the date which they become available for use.

Intangible assets are stated at cost less accumulated amortisation and provisions for impairment, if any, and are amortised over their useful lives as follows:

Computer software	3 to 9 years
Licences	3 to 5 years

Intangible assets are reviewed for impairment when there are indications that impairment may have occurred.

1.4.8 Leases
a) Overview
Leases entered into relate to land and buildings and vehicles and equipment.

Leases for land and buildings are split between leases for the land and leases for the buildings for accounting purposes only. The leases are separately assessed as to whether they are finance or operating leases. The policy is to provide for the minimum future lease payments on buildings that are not currently used, net of expected rental income from sub-leases. Provisions are made for dilapidation where an obligation exists to make good dilapidation or other damage, or return the asset to the configuration that existed at the inception of the lease.

Leases for vehicles and equipment are accounted for as operating leases.

b) Assets leased to customers
All leases of assets to customers are finance leases. Income from assets leased to customers is credited to the income statement based on a pattern reflecting a constant periodic rate of return on the net investment in the lease. An election to always measure the expected credit loss allowance at an amount equal to lifetime expected credit losses has not been applied.

c) Assets leased from third parties
i. Finance leases
The amount to be recognised as a finance lease is calculated on inception of the lease. Finance lease assets are capitalised at commencement of the lease (being the date at which the right to use the asset is exercised) at the lower of fair value of the leased asset and the present value of the minimum future lease payments, and subsequently in accordance with the relevant policy for the underlying asset. An equal liability is recorded in other liabilities. The interest element of the finance charge is allocated to the lease payments so as to record a constant periodic rate of charge on the outstanding liability.

ii. Operating leases
Operating lease payments are charged to the income statement on a straight line basis over the term of the lease and the asset is not recognised on the balance sheet.

1.4.9 Cash and cash equivalents
Cash and cash equivalents comprises cash balances and balances with a maturity of three months or less from the acquisition date, which are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value.

1.4.10 Income tax
a) Overview
Tax for the year comprises current and deferred tax, which is recognised in the income statement except to the extent that it relates to items recognised directly in equity, in which case it is recognised in the statement of comprehensive income. In 2017, estimated impacts of changes in the timing of amounts receivable from Co-operative Group for tax losses surrendered were recorded as an adjustment to the tax expense. This receivable is referred to as the Surrendered Loss Debtor, for further detail see note 2.2.5 Fair value of the Surrendered Loss Debtor.

b) Current tax
Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at the balance sheet date, and any adjustment to tax payable in respect of previous years.

c) Deferred tax
Deferred tax is provided using the balance sheet method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. The amount of deferred tax provided for is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantively enacted at the balance sheet date.

A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the asset can be utilised and is supported by the Plan.

Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

1.4.11 Retirement benefits
Defined contribution
A defined contribution (DC) scheme is a plan into which the Group and employees pay fixed contributions which are invested on their behalf by the trustee of the scheme. The Group has no legal or constructive obligation to pay any further contributions. The Group participates in the DC element of The Co-operative Pension Scheme (Pace DC), which is ring-fenced from the defined benefit section of the Pace scheme noted below. The cost of the employer contributions to the Group's DC plan is recognised as an expense in the income statement in the period in which they fall due.

Defined benefit
A defined benefit (DB) scheme is a pension plan that defines the amount of guaranteed pension benefit that an employee will receive on retirement based on a number of factors including the salary and years of service. The Group is the principal employer of two DB pension plans, The Bank Section of Co-operative Pension Scheme (Pace Complete) and the Britannia Pension Scheme (BPS). Both schemes are closed to new entrants and to future accrual. The assets of Pace Complete and BPS are held in separate trustee-administered funds.

The assets of a DB scheme are included at their fair value and scheme liabilities are measured on an actuarial basis using the projected unit credit method in accordance with IAS 19 Employee Benefits (IAS 19). The liabilities are discounted to present value using rates equivalent to market yields on high-quality corporate bonds at the balance sheet date with terms to maturity approximating to the terms of the related pension liability. A high quality corporate bond is usually taken to mean a bond that has been rated at the level of AA or equivalent status.

The Group's income statement includes the past service costs, net interest income or expense and scheme administration expenses. Past service costs represent the change in the present value of the defined benefit obligation arising from plan amendments or curtailment and are recognised when the plan amendment or curtailment occurs. Net interest income or expense is calculated by applying the discount rate at the beginning of the period to the net defined benefit liability or asset.

Remeasurements, comprising actuarial gains and losses, and the return on plan assets (excluding amounts included in net interest income or expense) are reflected immediately in the balance sheet with a charge or credit recognised in other comprehensive income in the period in which they occur. Remeasurements relate to the effects of differences between previous actuarial assumptions and what has actually occurred, and changes in forward-looking actuarial assumptions. They will not subsequently be reclassified to profit and loss.

The Group's balance sheet includes the net scheme surplus or deficit, being the difference between the fair value of the schemes' assets and the present value of scheme liabilities at the balance sheet date. Surpluses are recognised as an asset to the extent the Group has an unconditional right under the scheme rules to reduced contributions in future or refunds from the schemes in accordance with IFRIC 14 - The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction.

Further information relating to the Co-operative Pension Scheme DB section (Pace Complete)
Pace Complete is a multi-employer DB scheme. Until the current year, the Group could not reliably identify its share of defined benefit assets and liabilities and accordingly the scheme was accounted for as if it were a wholly defined contribution scheme, in accordance with IAS 19. However, during 2018 the Group, together with the Pace Trustee and Co-operative Group, progressed a project to ring-fence (sectionalise) the scheme, and accordingly became able to reliably estimate the Group's share of retirement benefit liabilities and associated assets in order to account for the scheme on a defined benefit basis under IAS 19 from 30 June 2018. Furthermore, on 6 August 2018 the assets and liabilities relating to the Group were legally sectionalised in the Bank Section of Pace.

1.4.12 Foreign currency
The functional and presentational currency is Pounds Sterling. Transactions in foreign currencies are translated at the foreign exchange rate prevailing at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are translated to Sterling at the foreign exchange rate prevailing at that date. Foreign currency differences arising on translation are recognised in the income statement, except for foreign currency differences arising on translation of FVOCI/available-for-sale equity instruments or a qualifying cash flow hedge, which are recognised directly in the statement of comprehensive income. Non-monetary assets and liabilities denominated in foreign currencies that are stated at fair value are translated to Sterling at the exchange rates prevailing at the dates the values were determined.

1.4.13 Investments in subsidiaries and Group undertakings
Investments in subsidiaries are initially measured at fair value which equates to cost and subsequently valued at cost less impairment.

1.4.14 Provisions
A provision is recognised in the balance sheet if there is a legal or constructive obligation as a result of a past event and it is probable that an outflow of economic benefits will be required to settle the obligation. If the effect is material, provisions are determined by discounting the expected future cash flows at an appropriate pre-tax rate, if the expected future cash flows can be reliably estimated.

In the case of restructuring provisions, a constructive obligation arises when a plan is sufficiently detailed and is formalised and when the plan is deemed to have been communicated to relevant stakeholders impacted by the restructure. Restructuring provisions include only direct expenditure arising from the restructuring plan which is both necessary for restructuring and not associated with ongoing activities.

1.4.15 Share premium
Share premium is the amount by which the fair value of the consideration received exceeds the nominal value of shares issued. Expenses and commissions paid on the issue of shares are written off against the share premium of the same issue.

1.4.16 Assets held-for-sale
Non-current assets and disposal groups (including both the assets and liabilities of the disposal groups) are classified as held-for-sale when their carrying amounts will be recovered principally through sale, they are available-for-sale in their present condition and their sale is highly probable.

Non-current assets held-for-sale and disposal groups are measured at the lower of their carrying amount and fair value less cost to sell, except for those assets and liabilities that are not within the scope of the measurement requirements of IFRS 5 (Non-current Assets held-for-sale and Discontinued Operations) such as deferred taxes, financial instruments, investment properties, insurance contracts and assets and liabilities arising from employee benefits. These are measured in accordance with the accounting policies described above. Immediately before the initial classification as held-for-sale, the carrying amounts of the asset (or assets and liabilities in the disposal group) are measured in accordance with applicable IFRSs. On subsequent re-measurement of a disposal group, the carrying amounts of the assets and liabilities noted above that are not within the scope of the measurement requirements of IFRS 5 are re-measured in accordance with applicable IFRSs before the fair value less costs to sell of the disposal group is determined.

1.4.17 Netting arrangements
Financial assets and financial liabilities are offset and the net amount reported in the balance sheet when there is a legally enforceable right to do so and there is an intention to settle on a net basis, or realise the asset and settle the liability simultaneously.

2. Critical accounting judgements and key sources of estimation uncertainty
The preparation of financial information requires management to make judgements 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. The critical judgements and estimates are the same for both the Group and Bank.

Assumptions and estimates 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 critical judgements and estimates which have a significant impact on the financial statements are described below:

2.1 Critical judgements

2.1.1 Recognition of IAS 19 pension valuation surplus

The Group is the principal employer of the Bank Section of The Co-operative Pension Scheme, a hybrid scheme, consisting of a closed defined benefit element and a defined contribution element. In addition, the Group through its wholly owned subsidiary BPS Principal Employer Limited is the principal employer in the Britannia Pension Scheme which is a defined benefit scheme.

During the year, Pace Complete was sectionalised as described in note 28 resulting in the Group now being able to identify its share of scheme assets and liabilities reliably. As a result, the scheme is now accounted for as a DB pension scheme and a surplus is recognised as a DB asset, along with the surplus recognised in respect of BPS. In order to recognise the DB asset in full, the Group must have an unconditional right to return of any surplus arising on wind up of the schemes, either in the form of reduced future contributions or in a form of a refund. The trustees of each scheme must not have the unilateral power to augment member benefits or wind up the scheme without cause. From discussions with the trustees and review of the scheme rules for Pace Complete and BPS, the Group believes the trustees cannot unilaterally augment benefits nor wind up those schemes without cause. Surplus contributions would be used to reduce future funding risk (and therefore reduce future contributions) or be refunded to the Group. Accordingly, the full value of the defined benefit scheme surplus has been recognised on the Group's balance sheet as an asset.

2.1.2 Recognition of Guaranteed Minimum Pensions (GMP) equalisation

A recent High Court Judgement has ruled that the requirement to provide the same benefit to male and female members of pension schemes applies to the level of GMPs. This judgement affects contracted out pension schemes including Pace Complete and BPS and, like many such schemes, Pace Complete and BPS had not previously allowed for this equalisation when calculating pension liabilities. The Group has determined that the High Court Judgement ruling gives sufficient evidence that increased payments to certain members are probable and a liability exists, the impact of which is recognised in the income statement in the current year.

2.2 Key sources of estimation uncertainty

2.2.1 Loan impairment provisions

a) Overview

The loan portfolios are reviewed on a regular basis to assess for impairment. In determining the expected credit loss impairment provision, the salient assumptions under IFRS 9 are as follows:

Assumption	Nature of assumption	Detailed information note reference
Criteria for identifying significant increase in credit risk	Whether at the reporting date, credit risk had increased significantly on a financial instrument since initial recognition (and therefore should be regarded as a stage 2 asset for impairment purposes attracting a lifetime ECL).	1.4.3 c) ii.
Criteria for defining default	Whether at the reporting date, a financial instrument is credit impaired (and therefore should be regarded as a stage 3 asset for impairment purposes attracting a lifetime ECL with interest income recognised on a net basis).	1.4.3 c) iii.
Incorporation of forward looking information	How the Group calculates a probability-weighted amount that is determined by evaluating a range of possible outcomes.	1.4.3 c) v.
Segmentation of portfolios	How assets should be grouped such that risk characteristics of assets within a group are homogeneous and the risk characteristics of each group are statistically significant to another.	1.4.3 c) vi.

All assumptions underpinning the ECL calculation are reviewed annually unless a micro or macro event occurs which triggers an interim review. There have been no significant changes in estimation techniques or significant assumptions made during the year.

Underpinning the above, the ECL calculation reflects management's view on parameters which are used to calculate PD, EAD and LGD. Management's view reflects detailed analysis based on historical information, overlaid with the Group's view of the macro economic environment.

The key parameters used to calculate PD, EAD and LGD are set out below:

	Retail secured and Optimum	Retail unsecured	Corporate secured	Corporate unsecured
PD	‣ 12 month and lifetime PDs based on observed defaults ‣ POCI assessment ‣ Probationary periods	‣ 12 month and lifetime PDs based on observed defaults ‣ POCI assessment ‣ Probationary periods	‣ 12 month and lifetime PDs based on observed defaults ‣ POCI assessment ‣ Probationary periods	‣ 12 month and lifetime PDs based on observed defaults ‣ POCI assessment ‣ Probationary periods
EAD	‣ Historical payment patterns	‣ Historical payment patterns	‣ Prepayment expectations	‣ Payment expectations plus credit conversion factors on undrawn revolving facilities
LGD	‣ Collateral values including customer repayment vehicle data ‣ Forced sale discounts ‣ Sale costs	‣ Debt collection strategies	‣ Collateral values ‣ Forced sale discounts ‣ Sale costs	‣ Debt collection strategies

b) Collective impairment provisions
Sensitivity analysis for the model variables which are most material to the collective ECL calculation is shown in the tables below. The table below illustrates the changes to the ECL as at 31 December 2018 that would result from reasonably possible changes in these parameters from the actual assumptions used in the Group's economic variable assumptions (for example, the impact on the ECL of increasing the expected unemployment rate by 2% (absolute percentage increase) in each of the base, upside, and downside scenarios with all other non-illustrated variables remaining constant). The changes in ECL include the impact of transition between Stage 1 and 2.

Increase/(decrease) in ECL	Retail secured	Optimum	Retail unsecured Loan and Current Account	Retail unsecured Cards	Corporate
Unemployment rate +2%	8.5%	32.7%	7.9%	-	-
Unemployment rate -2%	(3.6%)	(15.7%)	(7.2%)	-	-
Consumption growth +2%	-	-	-	(6.5%)	-
Consumption growth -2%	-	-	-	4.5%	-
GDP growth +2%	-	-	-	-	(13.2%)
GDP growth -2%	-	-	-	-	10.8%

c) Individual impairment 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. The individual provision element of the overall ECL calculation is considered to be most sensitive to collateral values. Sensitivity analysis has therefore been shown below:

Portfolio	-20%	+20%
Corporate	5.3%	(5.2%)

d) Scenario selection and weighting
In order that the ECL is a probability-weighted amount, which is determined by evaluating a range of possible outcomes and captures non linearities and asymmetries within the ECL calculation, a number of possible scenarios, together with their weightings are determined internally. Probability-weighted ECLs are calculated by applying each scenario to the ECL models and multiplying the result by the respective scenario weighting (see 1.4.3 c) v. above). The scenarios selected and the weightings applied to each scenario as at 31 December 2018 are set out below.

1 January 2018		31 December 2018	
Scenario	Weighting	Scenario	Weighting
Upside	25%	Upside	10%
		Mild upside	20%
Base	45%	Base	40%
Downside	30%	Mild downside	20%
		Downside	10%

The table below illustrates how the ECL would have changed if the weighting applied to the 31 December 2018 scenarios had been Upside 0%, Mild upside 0%, Base 40%, Mild downside 40% and Downside 20%.

	Retail secured	Optimum	Retail unsecured	Corporate	Total
Increase in ECL	+1.8%	+3.9%	+1.8%	+3.8%	+1.4%

2.2.2 Conduct risk and legal provisions

a) Overview
The amounts recognised as conduct risk and legal provisions are the best estimate of the consideration required to settle the present obligations at the reporting date, taking into account the risks and uncertainties surrounding the obligations.

The most significant component of the conduct risk and legal provision is potential customer redress in relation to Payment Protection Insurance (PPI). Provisions for conduct issues requiring redress which are individually less significant, have also been made.

The calculation of these conduct and legal provisions requires significant judgement by management in determining appropriate assumptions. Key assumptions include basis of redress, operating costs of resolving redress, legal analysis, the level of complaints, internal uphold rates, average redress, proactive contact and response rates and the FOS referral and uphold rates.

b) Payment Protection Insurance (PPI)
A provision of £67.8m (2017: £88.9m) has been recorded in respect of potential customer redress relating to past sales of PPI. The provision is in respect of the total expected cost of carrying out this work and paying compensation, making total provisions raised to date of £537.8m (2017: £498.3m).

The PPI charge is £39.5m in 2018, covering both redress and delivery. This charge reflects the continued high volumes of valid complaints being received through 2018 and is expected to continue into 2019.

The PPI provision is based on the FCA time-bar coming into force on 29 August 2019 in line with the FCA announcement on 2 March 2017. Other key assumptions are detailed within point a) above.

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

Description of estimate	Current position	Future expected[3]	Sensitivity on current position
Number of inbound valid complaints[1]	138k	24k	1,000 valid complaints received results in a £2.2m increase in provision
Number of proactive mailings	57k	-	1,000 additional mailings results in a £1.8m increase in provision
Response rate to proactive mailings	55%	38%	1% increase in response rate will increase the provision by £0.1m
Average uphold rate per valid complaints[1]	62%	72%	1% increase in uphold rate will increase the provision by £0.5m
Average redress per upheld complaint[2]	£3,187	£2,256	A £100 increase average inbound redress per upheld complaint will increase the provision by £1.7m

1. Valid complaints excludes those complaints for which no PPI policy exists.
2. Average redress per upheld complaint includes all complaints either inbound or in response to proactive mailings that were offered redress.
3. Future is defined as the period until all complaints have been received following the time-bar.

2.2.3 Estimate of the defined benefit pension valuation including allowance for GMP equalisation
Actuarial valuations of the defined benefit schemes are conducted as determined by the pension scheme trustees, at an interval of not more than three years. Results before tax and net assets are affected by the actuarial assumptions used. The key assumptions include: discount rates, mortality rates and increases to pensions in payment (including GMP equalisation) and to deferred pensions. Actual rates may differ significantly from the assumptions used due to changing market and economic conditions and longer or shorter lives of members, and as such, this represents a key source of estimation uncertainty. Sensitivities in respect of the assumptions are disclosed in note 28 for Pace Complete and BPS.

An estimate of the cost of GMP equalisation has been made, and on the basis that neither Pace Complete nor BPS has recognised an estimate of the liability in this regard previously, the cost is recognised through the income statement immediately rather than as a remeasurement through other comprehensive income (OCI). In common with many schemes, the full calculation of the impact is a significant task and is not complete at the balance sheet date. Therefore in future years, any remeasurement of the estimated liability will be reflected as a change in estimate through OCI.

2.2.4 Effective interest rate
When calculating the EIR to apply to an asset or liability held at amortised cost, the Group estimates future cash flows considering all contractual terms of an instrument. In most cases, the future cash flows arising from an asset or liability will be dependent on a number of variables, such as the proportion of mortgage customers who do not switch product after a discount period ends, or future interest rates set by the market. Therefore, it follows that management is required to apply significant judgement in creating assumptions about the value of these variables in the future.

In calculating the EIR adjustment to apply to mortgage balances, the most significant two assumptions in terms of impact and volatility are:

- **Standard variable rate:**
  The assumed standard variable rate which will be in effect at the end of a fixed rate product term determines expected income to be received post-reversion. This is determined with reference to expected Bank of England base rate rises, with a proportion of future increases assumed to pass through to the Group's standard variable rate (SVR).

  As a measure of the sensitivity of these models, a 0.5% increase in the assumed SVR in place after the expiry of the fixed rate period for all products would result in a £5.0m (9.0%) increase in the EIR asset within the loans and advances to customers balance as at 31 December 2018.

- **Timing of redemptions (behavioural lives):**
  Once a customer reaches the expiry of the fixed rate period on the fixed product, interest is charged at the Group's standard SVR, which is higher than the product fixed rate. The amount of time that the customer stays on SVR affects the total lifetime income from the customer, which affects the EIR adjustment.

  As a measure of the sensitivity of these models, if all repayments forecast to occur after the expiry of the fixed rate period for all products were to occur one month earlier would result in a £3.5m (6.2%) decrease in the EIR asset within the loans and advances to customers balance as at 31 December 2018.

The EIR adjustment on non-mortgage balances is not material.

2.2.5 Fair value of the Surrendered Loss Debtor

As part of the negotiations relating to the separation of the Group from Co-operative Group, the Group and Co-operative Group agreed terms relating to the surrender of group relief between the entities in the Bank's tax group and entities in Co-operative Group tax group. A deed sets out the basis of the agreement by Co-operative Group to take proactive steps to allow it to maximise its claim for tax losses from the Bank for the accounting periods to 31 December 2012 and 31 December 2013. The deed also addresses the terms of the payment by Co-operative Group to the Bank for those tax losses. The 2018 consolidated financial statements, which include a Surrendered Loss Debtor at a fair value of £32.9m (2017: amortised cost £71.6m), have been prepared on a basis consistent with the deed. The gross undiscounted amount payable by Co-operative Group under the terms of the deed is estimated to be approximately £131m.

The Bank receives payment from Co-operative Group when Co-operative Group realises the benefit of the losses surrendered and at the corporation tax rate at which the benefit is realised. The estimated fair value of the asset is highly sensitive to a number of forward looking assumptions outside the control of the Group including:

- the forecast repayments provided by Co-operative Group for the periods to 2021;
- the assumptions used in the discount rate;
- Co-operative Group's capital expenditure qualifying for capital allowances in future periods;
- Co-operative Group's taxable profits in future periods;
- the Bank's extrapolation of the forecast repayments for the periods after 2021;
- changes in tax legislation, including the rate of corporation tax and the rates at which capital allowances on qualifying capital expenditure are available;
- Co-operative Group's capacity to claim the tax losses; and
- the quantum of the illiquidity adjustment.

Following the adoption of IFRS 9 on 1 January 2018, the Surrendered Loss Debtor is required to be measured at fair value (see note 36 for further details and note 33 for the valuation methodology). The requirement to measure this financial instrument introduces further management judgement and estimation uncertainty beyond that under its IAS 39 amortised cost measurement.

Scenario	Result
Deferral of receipt of payments applied in the payment forecast	If future payments from Co-operative Group are deferred by one year from the current estimates, the value of the Surrendered Loss Debtor decreases by £2.7m.
Changes in tax rates applied in the payment forecast	Increasing the corporation tax rate by 1% from 1 April 2020 throughout the life of the SLD increases the value of the Surrendered Loss Debtor increases by £1.8m.
Changes in the discount rate used to calculate the present value of the payment forecast	If the variables used to build up the discount rate change such that the total discount rate increases by 1%, the value of the Surrendered Loss Debtor decreases by £3.6m.

If the illiquidity adjustment was assumed to be 10% higher, this would not result in a material change in the value of the Surrendered Loss Debtor.

3. Segmental information

The corporate book was managed as two divisions during the prior year, BaCB and legacy. As of 2018, corporate is managed as one division. Revenues are attributed to the segment in which they are generated. 2017 has also been re-presented to show an updated analysis of expenditure in line with the current management and reporting of the costs.

The Board relies primarily on net interest income to assess the performance of each segment. As a result, interest income is reported on a net basis to the Board.

The table below represents the management accounts, as presented in the detailed financial review:

2018	**Retail**	**Corporate**	**Treasury**	**Optimum**	**Other**	**Total**
Net interest income	289.8	45.8	3.7	11.5	(0.3)	**350.5**
Other operating income/(expense)	13.2	18.6	(1.6)	0.9	3.6	**34.7**
Operating income	**303.0**	**64.4**	**2.1**	**12.4**	**3.3**	**385.2**
Net credit impairment (losses)/gains	(7.2)	9.3	-	1.6	-	**3.7**
Income net of impairment	**295.8**	**73.7**	**2.1**	**14.0**	**3.3**	**388.9**
Operating costs – staff						**(129.2)**
Operating costs – non-staff						**(226.2)**
Continuous improvement projects[1]						**(18.6)**
Operating profit						**14.9**
Net customer redress charge						**(31.7)**
Strategic projects						**(94.3)**
Non-operating expense						**(29.6)**
Group loss before tax						**(140.7)**
Income tax						**72.0**
Group loss after tax						**(68.7)**

2017	Retail	Corporate	Treasury	Optimum	Other	Total
Net interest income/(expense)	274.1	41.5	(28.5)	28.7	1.8	317.6
Other operating income/(expense)	19.1	12.0	18.8	(21.0)	(0.5)	28.4
Operating income/(expense)	293.2	53.5	(9.7)	7.7	1.3	346.0
Net credit impairment (losses)/gains	(9.1)	4.6	-	5.6	-	1.1
Income/(expense) net of impairment	284.1	58.1	(9.7)	13.3	1.3	347.1
Operating costs – staff						(152.4)
Operating costs – non staff						(258.9)
Continuous improvement projects[1]						(19.8)
Operating loss						(84.0)
Net customer redress charge						(27.4)
Strategic projects						(53.3)
Non-operating income/(expense)						431.0
Share of post-tax profits from joint ventures						0.4
Fair value amortisation						(50.7)
Group profit before tax						216.0
Income tax						16.7
Group profit after tax						232.7
Group consolidation adjustment						(390.4)
Bank loss after tax						(157.7)

1. Includes mandatory and regulatory projects.

The table below represents the reconciliation of the management accounts presentation in the detailed financial review and the segmental note to the consolidated income statement:

	Group and Bank	
	2018	2017[1]
Net interest income		
Net interest income for reportable segments	**350.5**	317.6
Interest fair value unwind	**-**	(53.5)
Adjustment to recognise interest on stage 3 assets based on their net carrying value	**(1.8)**	-
Net interest on defined benefit pension schemes	**10.7**	-
Net customer redress charge	**-**	(0.4)
Net interest income in the consolidated financial statements	**359.4**	263.7
Other operating income/(expense)		
Other operating income for reportable segments	**34.7**	28.4
Asset sales impairment release	**-**	3.0
Fair value loss on the Surrendered Loss Debtor	**(28.1)**	-
Gains on share sales	**0.2**	22.8
Net customer redress charge	**2.5**	-
Interest fair value unwind	**-**	9.8
Total other operating income in the consolidated financial statements	**9.3**	64.0
Comprising:		
Net fee and commission income	**20.2**	26.8
Income from investments	**0.1**	0.2
Other operating (expense)/income (net)	**(11.0)**	37.0
	9.3	64.0
Operating expenses		
Operating costs for reportable segments	**(355.4)**	(411.3)
Project costs	**(112.9)**	(73.1)
Past service pension costs (GMP)	**(12.4)**	-
Restructuring and recapitalisation included within operating expenses	**-**	(41.5)
Fair value unwind	**-**	(7.0)
Operating expenses in the consolidated financial statements	**(480.7)**	(532.9)
Net customer redress charge		
Net customer redress charge included in reportable segments	**(31.7)**	(27.4)
Legal charges included within operating expenses	**-**	0.4
Net customer redress charge included in other operating (expense)/income (net)	**(2.5)**	-
Net customer redress charge	**(34.2)**	(27.0)
Interest fair value unwind		
Fair value unwind for reportable segments	**-**	(50.7)
Interest fair value unwind	**-**	53.5
Non-interest income fair value unwind	**-**	(9.8)
Fair value unwind reported in operating expenses	**-**	7.0
Interest fair value unwind in the consolidated financial statements	**-**	-
Impairment gains on loans and advances		
Impairment gains on loans and advances for reportable segments	**3.7**	1.1
Asset sales impairment release included within non-interest income	**-**	(3.0)
Adjustment to recognise interest on stage 3 assets based on their net carrying value	**1.8**	-
Impairment gains/(losses) on loans and advances in the consolidated financial statements	**5.5**	(1.9)

1. Reportable segments as explained in the detailed financial review.

	Group and Bank	
	2018	2017
Non-operating (expense)/income		
Non-operating (expense)/income for reportable segments	**(29.6)**	431.0
Fair value loss on the Surrendered Loss Debtor	**28.1**	-
Net interest expense on defined benefit scheme	**(10.7)**	-
Past service pension costs (GMP)	**12.4**	-
Gains on share sale	**(0.2)**	(22.8)
Gain on pension scheme modification	**-**	(51.9)
Gain on restructuring and recapitalisation excluded	**-**	(397.8)
Restructuring and recapitalisation included within operating expenses	**-**	41.5
Non-operating income/(expense) in the consolidated financial statements	**-**	-

The table below represents segmental analysis of assets and liabilities on a management accounts basis as presented in the detailed financial review:

2018	**Retail**	**Corporate**	**Treasury**	**Optimum**	**Other**	**Total**
Segment assets	15,971.8	1,163.3	4,501.9	529.5	936.3	**23,102.8**
Segment liabilities	16,595.3	2,118.6	2,309.3	-	329.5	**21,352.7**

2017 (re-presented)[1]	Retail	Corporate	Treasury	Optimum	Other	Total
Segment assets	14,688.4	1,442.0	7,258.3	593.6	507.8	24,490.1
Segment liabilities	18,329.8	2,225.4	2,088.1	-	341.2	22,984.5

1. 2017 was previously reported as legacy / BaCB. This has been amalgamated as corporate.

4. Auditor's remuneration

	Group and Bank	
	2018	2017
	£'000	£'000
Fees payable to the Bank's auditor for the audit of the annual accounts	**2,575**	2,985
Audit expenses	**180**	200
Fees payable to the Bank's auditor for other services:		
Audit of the accounts of subsidiaries	**110**	110
Audit-related assurance services	**-**	160
Other assurance services	**64**	45
Total audit fees and expenses for the financial year	**2,929**	3,500
All other services provided by the auditor	**-**	2,000
Total auditor's remuneration	**2,929**	5,500

The table above includes 2017 fees payable to the auditor as disclosed within the 2017 financial statements. Subsequent to their approval an additional £25,000 for the audit of subsidiaries was approved. Bank Company has borne the cost of the audit fees for the consolidated Group.

5. Directors' emoluments

	Group and Bank	
	2018	2017
Total remuneration receivable by Directors	**6.2**	5.3

No retirement benefits are accruing to Directors under defined benefit schemes. The aggregate of emoluments and amounts receivable under incentive schemes of the highest paid Director was £2.5m (2017: £2.3m).

6. Net interest income

a) Interest income and similar income

	Group and Bank							
	2018				2017[1]			
	Amortised cost	**FVOCI**	**Other**	**Total**	Amortised cost	AFS	Other	Total
Interest income and similar income								
On financial assets not at fair value through profit or loss:								
Loans and advances to customers	**444.3**	**-**	**8.4**	**452.7**	511.9	-	8.9	520.8
Loans and advances to banks	**16.9**	**-**	**-**	**16.9**	7.9	-	-	7.9
Investment securities	**1.5**	**40.7**	**-**	**42.2**	0.4	51.9	-	52.3
Net interest income on net defined benefit pension asset[2]	**-**	**-**	**10.9**	**10.9**	-	-	0.6	0.6
Total interest income and similar income on financial assets not at FVTPL	**462.7**	**40.7**	**19.3**	**522.7**	520.2	51.9	9.5	581.6
On financial assets at fair value through profit or loss:								
Net interest expense on financial instruments hedging assets	**-**	**-**	**(19.0)**	**(19.0)**	-	-	(31.9)	(31.9)
Net interest income on financial instruments not in a hedging relationship	**-**	**-**	**2.3**	**2.3**	-	-	5.2	5.2
Total interest income/(expense) and similar income	**462.7**	**40.7**	**2.6**	**506.0**	520.2	51.9	(17.2)	554.9

b) Interest expense and similar charges

	Group and Bank					
	2018			2017[1]		
	Amortised cost	**Other**	**Total**	Amortised cost	Other	Total
Interest expense and similar charges						
On financial liabilities not at fair value through profit or loss:						
Customer accounts	**(108.7)**	**-**	**(108.7)**	(128.4)	-	(128.4)
Subordinated liabilities, debt securities in issue and other deposits	**(39.8)**	**(0.5)**	**(40.3)**	(154.7)	(0.8)	(155.5)
Net interest expense on unfunded schemes[2]	**-**	**(0.2)**	**(0.2)**	-	(0.2)	(0.2)
Total interest expense and similar charges on financial liabilities not at FVTPL	**(148.5)**	**(0.7)**	**(149.2)**	(283.1)	(1.0)	(284.1)
On financial liabilities at fair value through profit or loss:						
Net interest income/(expense) on financial instruments hedging liabilities	**-**	**5.2**	**5.2**	-	(3.8)	(3.8)
Net interest expense on financial instruments not in a hedging relationship	**-**	**(2.6)**	**(2.6)**	-	(3.3)	(3.3)
Total interest expense and similar charges	**(148.5)**	**1.9**	**(146.6)**	(283.1)	(8.1)	(291.2)

1. In accordance with the transitional provisions in IFRS 9, comparative figures have not been restated. See note 36 to the consolidated financial statements for details of changes in accounting policy.
2. See note 28 for details on retirement benefits.

2017 interest expense on subordinated liabilities and debt securities in issue includes fair value unwind on debt securities in issue of £58.3m. The Leek Finance Number Nineteen plc debt securities were redeemed on 21 June 2017, and correspondingly the expense in 2018 was £nil.

7. Net fee and commission income

The net fee and commission income for the Group and Bank relates to items not at fair value through profit or loss. There were no changes to the way revenue is recorded on adoption of IFRS 15 on 1 January 2018, see note 1 for further details.

8. Other operating (expense)/income (net)

	Group and Bank	
	2018	2017[1]
Profit on sale of investment securities	**2.8**	6.3
Gain on sale of shares[2]	**0.2**	22.8
Gain/(loss) on sale of loans and advances to customers	**2.0**	(11.5)
Fair value movement on loans and advances to customers designated at fair value	**(6.7)**	(6.5)
Fair value movement on loans and advances to customers held-for-trading	**-**	0.1
Income from derivatives and hedge accounting	**1.0**	16.6
(Expense)/income from assets and liabilities held at fair value through profit or loss[3]	**(27.1)**	2.4
Foreign exchange gains	**9.1**	5.3
Change in fair value of investment properties	**-**	0.1
Other operating income	**7.7**	1.4
Total other operating (expense)/income (net)	**(11.0)**	37.0

1. In accordance with the transitional provisions in IFRS 9, comparative figures have not been restated. See note 36 to the consolidated financial statements for details of changes in accounting policy.
2. This gain has arisen in 2018 as a result of the sale of shares in Britannia Personal Lending Limited (2017: VocaLink Holdings Limited).
3. (Expense)/income from assets and liabilities held at fair value through profit or loss of £(27.1)m (2017: £2.4m) includes a £28.1m loss on the Surrendered Loss Debtor (that was measured at amortised cost in the comparative period) and a £2.1m gain on equity shares previously classified as available-for-sale in the comparative period.

Within the table above, in 2018 hedge ineffectiveness created an expense of £6.8m in relation to fair value hedge programmes. In 2017, hedge ineffectiveness generated a £7.2m gain of which £5.4m was related to cashflow hedge programmes and £1.8m from fair value programmes.

9. Operating expenses

		Group and Bank	
	Note	**2018**	2017
Staff costs	10	**189.1**	200.0
Depreciation of property, plant and equipment	20	**4.6**	4.2
Amortisation of intangible fixed assets	21	**26.7**	31.2
Impairment of property, plant and equipment	20	**1.4**	0.5
Impairment of intangible assets	21	**0.8**	3.1
Profit on sale of property, plant and equipment		**(2.1)**	(0.1)
Operating lease rentals		**10.1**	15.0
Provisions for liabilities provided in the year	26	**11.9**	16.6
Other expenses		**238.2**	262.4
Total operating expenses		**480.7**	532.9

10. Staff costs

		Group and Bank	
	Note	**2018**	2017
Wages and salaries		**113.7**	123.4
Social security costs		**12.0**	13.0
Pension costs:			
Defined benefit GMP equalisation – past service cost	28	**12.4**	-
Defined benefit plans – other costs	28	**-**	5.0
Defined contribution plans	28	**7.4**	7.7
Other staff costs		**43.6**	50.9
Total staff costs		**189.1**	200.0

Other staff costs primarily include costs paid to contractors and severance costs.

Average number of employees

The average headcount of persons working during the year is as follows:

	Group and Bank	
	No. of employees 2018	No. of employees 2017
Full time	**2,746**	3,072
Part time	**801**	893
	3,547	3,965

11. Income tax

	Group and Bank	
	2018	2017
Current tax		
Current year	**-**	8.5
Prior year	**(1.1)**	(0.1)
Total current tax (credit)/charge	**(1.1)**	8.4
Deferred tax		
Current year	**(76.6)**	(27.3)
Impact of corporation tax rate changes	**5.7**	2.2
Total deferred tax credit	**(70.9)**	(25.1)
Total tax credit	**(72.0)**	(16.7)

In addition to the above, included within other comprehensive income is a deferred tax charge of £110.9m (2017: £6.9m).

Further information on deferred tax is presented in note 27 to the consolidated financial statements. The tax on the (loss)/profit before taxation differs from the theoretical amount that would arise using the corporation tax rate in the UK as follows:

	Group		Bank	
	2018	2017	**2018**	2017
(Loss)/profit before taxation	**(140.7)**	216.0	**(140.7)**	(174.4)
Tax charge/(credit) calculated at a rate of 19% (2017: 19.25%)	**(26.7)**	41.6	**(26.7)**	(33.5)
Effects of:				
Movement in unrecognised deferred tax	**(37.4)**	(5.5)	**(37.4)**	(5.5)
Impact of surcharge on deferred tax	**(23.1)**	(2.4)	**(23.1)**	(2.4)
Expenses not deductible for tax purposes	**11.8**	12.7	**11.8**	12.7
Impact of corporation tax rate change	**5.7**	2.2	**5.7**	2.2
Non-taxable income	**(1.3)**	-	**(1.3)**	-
Adjustments to tax charge in respect of prior periods	**(1.1)**	(0.1)	**(1.1)**	(0.1)
Other differences	**0.1**	1.4	**0.1**	1.4
Non-taxable gain on restructuring and recapitalisation	**-**	(75.1)	**-**	-
Discount of Surrendered Loss Debtor	**-**	(5.6)	**-**	(5.6)
Adjustment to Surrendered Loss Debtor	**-**	14.1	**-**	14.1
	(72.0)	(16.7)	**(72.0)**	(16.7)

Changes in the amount receivable from Co-operative Group for tax losses surrendered (the Surrendered Loss Debtor) are recorded within other operating income in the year to 31 December 2018 following remeasurement of this financial asset to FVTPL on transition to IFRS 9. Expenses not deductible for tax purposes include movements in the Surrendered Loss Debtor and provisions for compensation payments (net customer redress charge), for which tax relief has been restricted.

12. Cash and balances at central banks

	Group and Bank	
	2018	2017
Cash in hand	**14.2**	49.1
Items in transit	**(27.3)**	(35.9)
Balances with the Bank of England other than mandatory reserve deposits	**1,802.7**	3,981.3
Included in cash and cash equivalents	**1,789.6**	3,994.5
Mandatory reserve deposits with the Bank of England	**54.2**	37.6
	1,843.8	4,032.1

Mandatory reserve deposits are not available for use in the day-to-day operations, are non-interest bearing and are not included in cash and cash equivalents. Items in transit represent unpresented cheques awaiting clearance.

13. Loans and advances to banks

	Group and Bank	
	2018	2017
Items in course of collection from other banks	**2.4**	12.8
Placements with other banks[1]	**401.9**	462.1
Included in cash and cash equivalents	**404.3**	474.9
Other loans and advances to banks	**81.5**	99.9
	485.8	574.8

1. Obligatory netting arrangements are in place for repos and reverse repos transactions. As a result, the amount reduced by netting is £100.0m (2017: £300.0m), with the opposing impact in Deposits by banks in note 22 to the consolidated financial statements.

An expected credit loss of £nil was recorded as at 31 December 2018 (2017: £nil) in relation to loans and advances to banks.

14. Loans and advances to customers

a) Analysis of the balance sheet

	Group and Bank	
	2018	2017[1]
Gross loans and advances	**17,786.6**	16,824.5
Less: allowance for losses	**(52.7)**	(80.0)
	17,733.9	16,744.5

1. In accordance with the transitional provisions in IFRS 9, comparative figures have not been restated. See note 36 to the consolidated financial statements for details of changes in accounting policy.

Loans and advances to customers include £148.5m (2017: £178.2m) of financial assets at fair value through profit or loss to eliminate or significantly reduce a measurement or recognition inconsistency. Of these, £63.5m (2017: £80.2m) are secured by real estate collateral.

Loans and advances to customers include £1.2bn (2017: £1.2bn) pledged under the securitisation and covered bond activities. There remains exposure to substantially all of the risks and rewards of ownership of these assets. Secured on these mortgage assets are £0.6bn (2017: £0.6bn) of fixed and floating rate notes.

b) Concentration of exposure

Exposure is predominantly within the UK. Further information on the concentration of exposure is included within the risk management disclosures.

c) Analysis of allowance for losses

	Group and Bank						
	Retail		Optimum		Corporate		
2018 (IFRS 9)	**Individual**	**Collective**	**Individual**	**Collective**	**Individual**	**Collective**	**Total**
At the beginning of the year as reported under IAS 39	-	41.1	-	8.0	29.0	1.9	**80.0**
IFRS 9 opening balance adjustments	-	(2.0)	-	-	-	2.9	**0.9**
At the beginning of the year adjusted for IFRS 9	**-**	**39.1**	**-**	**8.0**	**29.0**	**4.8**	**80.9**
Changes in assets which transitioned during the year[1]:							
To lifetime ECL	-	1.3	-	-	-	-	**1.3**
To credit impaired	-	4.6	-	0.2	0.1	-	**4.9**
To 12 month ECL	-	(0.8)	-	-	-	(0.2)	**(1.0)**
From credit impaired	-	(1.9)	-	(0.2)	(0.3)	-	**(2.4)**
Net changes in assets which transitioned during the year	-	**3.2**	**-**	**-**	**(0.2)**	**(0.2)**	**2.8**
Other charges/(releases):							
New assets originated or purchased	-	2.7	-	-	-	-	**2.7**
Other changes to risk parameters[2]	-	2.1	-	(1.6)	(5.7)	(2.0)	**(7.2)**
Net other charges/(releases)	**-**	**8.0**	**-**	**(1.6)**	**(5.9)**	**(2.2)**	**(1.7)**
Assets written off	-	(22.3)	-	(1.4)	(2.8)	-	**(26.5)**
At the end of the year	**-**	**24.8**	**-**	**5.0**	**20.3**	**2.6**	**52.7**

1. Includes the impact of both transition and repayments on assets which transitioned during the year.
2. Includes repayments (other than those related to assets which transitioned during the year) and changes due to other model inputs.

	Group and Bank						
	Retail		Optimum		Corporate		
2017[1] (IAS 39)	Individual	Collective	Individual	Collective	Individual	Collective	Total
At the beginning of the year as reported	-	61.3	-	12.5	46.7	1.8	122.3
Charge/(release) against profits	-	10.6	-	(4.6)	(2.4)	0.1	3.7
Amounts written off	-	(30.8)	-	(3.2)	(15.2)	-	(49.2)
Unwind of discount allowance	-	-	-	-	(0.1)	-	(0.1)
Merger fair value write off[2]	-	-	-	3.3	-	-	3.3
At the end of the year	-	41.1	-	8.0	29.0	1.9	80.0

1. In accordance with the transitional provisions in IFRS 9, comparative figures have not been restated. See note 36 to the consolidated financial statements for details of changes in accounting policy.
2. The remaining Britannia merger fair value was written off in 2017. Refer to note 34 to the consolidated financial statements in the 2017 Annual Report and Accounts for further information.

d) Analysis of income statement

	Group and Bank
IFRS 9	**2018**
Release - Net other charges/(releases) shown above	**1.7**
Amounts recovered against amounts previously written off	**1.9**
Adjustment to recognise interest on stage 3 assets based on their net carrying value	**1.8**
Provision against fair value adjustments for hedged risk	**0.1**
Net impairment gain for the year as shown in the income statement	**5.5**

Provisions are analysed by segment and by IFRS 9 stage in the risk management disclosures.

	Group and Bank
IAS 39	2017
Charge against profits shown above	(3.7)
Transfer to loss on sale of assets - loans and receivables	(3.0)
Amounts recovered against amounts previously written off	4.9
Provision against fair value adjustment for hedged risk	(0.1)
Net impairment loss for the year as shown in the income statement	(1.9)

e) Finance lease receivables

	Group and Bank	
	2018	2017
Gross investment in finance leases may be analysed as follows:		
No later than one year	**3.9**	5.2
Later than one year and no later than five years	**11.2**	13.2
Later than five years	**9.8**	11.6
	24.9	30.0
Unearned future finance income on finance leases	**(6.4)**	(7.7)
Net investment in finance leases	**18.5**	22.3

	2018	2017
The net future finance leases may be analysed as follows:		
No later than one year	**2.7**	3.8
Later than one year and no later than five years	**8.5**	10.0
Later than five years	**7.3**	8.5
	18.5	22.3

The unguaranteed residual value of the finance leases is £nil (2017: £nil). Finance lease arrangements are with customers in a wide range of sectors including transport, retail and utilities.

15. Investment securities

a) Analysis of investment securities

	Group and Bank							
	2018				2017[1]			
	Amortised cost	**FVOCI**	**FVTPL**	**Total**	Loans and receivables	AFS[2]	FVTPL[3]	Total
Gross and net investment securities (listed)	**89.1**	**1,842.4**	**3.5**	**1,935.0**	100.0	2,287.7	-	2,387.7

b) Movement in investment securities

	Group and Bank							
	2018				2017[1]			
	Amortised cost	**FVOCI**	**FVTPL**	**Total**	Loans and receivables	AFS[2]	FVTPL[3]	Total
At the beginning of the year	**100.0**	**2,283.2**	**4.5**	**2,387.7**	13.8	3,538.1	-	3,551.9
Acquisitions	**-**	**462.6**	**-**	**462.6**	86.8	321.3	-	408.1
Disposals and maturities	**(10.7)**	**(862.0)**	**-**	**(872.7)**	(0.9)	(1,520.8)	-	(1,521.7)
Fair value movements through equity	**-**	**(5.0)**	**-**	**(5.0)**	-	(0.5)	-	(0.5)
Fair value through profit or loss	**-**	**(35.0)**	**(1.0)**	**(36.0)**	-	(48.5)	-	(48.5)
Amortisation	**-**	**1.1**	**-**	**1.1**	-	2.6	-	2.6
Movement in interest accrual	**(0.2)**	**(2.5)**	**-**	**(2.7)**	0.3	(6.2)	-	(5.9)
Write back of previously written off assets	**-**	**-**	**-**	**-**	-	1.7	-	1.7
At the end of the year	**89.1**	**1,842.4**	**3.5**	**1,935.0**	100.0	2,287.7	-	2,387.7

1. In accordance with the transitional provisions in IFRS 9, comparative figures have not been restated. See note 36 to the consolidated financial statements for details of changes in accounting policy.
2. The current year balances for investment securities AFS are £nil as this category does not exist following transition to IFRS 9.
3. The comparatives for investment securities FVTPL is £nil as all investment securities held as at 31 December 2017 were classified as AFS or amortised cost under IAS 39.

Included in investment securities are repurchase receivables of £329.4m. These receivables are gilts subject to repurchase transactions where the transferee has the ability to re-pledge or sell the assets. £165.1m of Warwick Finance Two securitisation notes have been pledged, with a 17% haircut, as security against the increased shortfall in the actuarial funding shortfall estimated by the Britannia Pension Scheme actuary on 5 April 2017. £276.9m AAA rated Silk Road 4 securitisation notes, with a 22% haircut, have been pledged against the Pace Complete scheme as estimated by the Pace scheme actuary in April 2016. See note 28 to the consolidated financial statements for further details.

c) Analysis of investment securities by issuer

	Group and Bank	
	2018	2017
Investment securities issued by public bodies:		
Government securities	**926.6**	1,113.0
Other public sector securities	**309.1**	223.8
Total investment securities issued by public bodies	**1,235.7**	1,336.8
Other debt securities:		
Other fixed and floating rate notes	**207.3**	127.4
Mortgage backed securities	**492.0**	923.5
Total investment securities issued by other issuers	**699.3**	1,050.9
Total investment securities	**1,935.0**	2,387.7

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

16. Derivative financial instruments

Various derivatives have been entered into to manage interest rate risk, some of which are held in a qualifying hedge accounting relationship (see the risk management section for more details on interest rate risk management strategies). Positive and negative fair values have not been netted off as there is not a legal right of offset.

Non-trading derivatives

Non-trading transactions comprise derivatives held for hedging purposes to manage the asset and liability positions of the Group. Derivatives used to manage interest rate related positions include swaps, caps and floors and forward rate agreements. The foreign exchange rate positions are managed using forward currency transactions and swaps.

	Group and Bank			
	2018 Fair value		2017 Fair value	
	Assets	**Liabilities**	Assets	Liabilities
Derivatives held for non-trading purposes				
Derivatives designated as cash flow hedges:				
Interest rate swaps	**32.7**	**(9.8)**	44.7	(4.9)
Derivatives designated as fair value hedges:				
Interest rate swaps	**28.6**	**(106.5)**	32.8	(136.9)
Derivatives held for non-trading purposes for which hedge accounting has not been applied:				
Interest rate swaps	**130.9**	**(144.0)**	154.4	(172.8)
Forward currency transactions	**-**	**(0.3)**	0.5	(0.4)
Total derivative assets/(liabilities) held for non-trading purposes	**192.2**	**(260.6)**	232.4	(315.0)
Total recognised derivative assets/(liabilities)	**192.2**	**(260.6)**	232.4	(315.0)

The derivatives designated as cash flow hedges are interest rate swaps used to hedge interest rate risk in retail operations. Cash flows are hedged by quarterly time periods for durations up to six years. During the year, there were no forecast transactions for which hedge accounting had previously been used but are no longer expected to occur.

In line with industry standards, credit valuation adjustments (CVAs) and debit valuation adjustments (DVAs) are applied to non-collateralised swaps representing the fair value measurement of counterparty risk. The net credit adjustment across the portfolio at the end of 2018 was £0.6m (2017: £0.7m). CVAs and DVAs are not applied to derivatives that are fully cash collateralised.

17. Equity shares

	Group and Bank	
	2018	2017[1]
	FVTPL	AFS
Investment securities:		
Listed	**0.4**	0.3
Unlisted	**26.0**	26.3
	26.4	26.6
Included above are the following unlisted trade investments:		
Unity Trust Bank - nil (2017: 1,130,000 ordinary shares)	-	2.3
Visa International - 38,847 Series B Preference Shares (2017: 38,847)	**26.0**	24.0

1. In accordance with the transitional provisions in IFRS 9, comparative figures have not been restated. See note 36 to the consolidated financial statements for details of changes in accounting policy.

Equity shares in 2018 are classified as FVTPL under IFRS 9 as no elections to measure at FVOCI were made. Equity shares in 2017 were classified as available-for-sale under IAS 39. The valuation technique used to calculate the fair value of equity shares is set out in note 33 to the consolidated financial statements. In 2018, Unity Trust Bank bought back the remainder of their shares.

18. Other assets

	2018			2017[1]
	Amortised cost	**Mandatorily measured at FVTPL**	**Total**	Loans and receivables
Amounts recoverable within one year				
Other assets	**17.3**	**-**	**17.3**	19.3
Amounts owed by Co-operative Group	**-**	**1.4**	**1.4**	-
Deferred consideration receivable	**4.5**	**-**	**4.5**	-
Total amounts recoverable within one year	**21.8**	**1.4**	**23.2**	19.3
Amounts recoverable after more than one year				
Amounts owed by Co-operative Group	**-**	**31.5**	**31.5**	71.6
Deferred consideration receivable	**-**	**-**	**-**	4.4
Total amounts recoverable after more than one year	**-**	**31.5**	**31.5**	76.0
Total other assets	**21.8**	**32.9**	**54.7**	95.3

1. In accordance with the transitional provisions in IFRS 9, comparative figures have not been restated. See note 36 to the consolidated financial statements for details of changes in accounting policy.

Amounts owed by Co-operative Group relates to the Surrendered Loss Debtor of £32.9m (2017: £71.6m).

19. Prepayments and accrued income

	Group and Bank	
	2018	2017
Amounts recoverable within one year	**30.9**	24.1
Amounts recoverable after more than one year	**0.9**	0.6
Total prepayments and accrued income	**31.8**	24.7

20. Property, plant and equipment

2018	Note	Group and Bank Land and buildings	Leasehold improvements	Computers and other equipment	Assets in the course of construction	Total
Cost						
At the beginning of the year		16.1	14.6	40.7	4.8	**76.2**
Additions		-	-	0.1	5.9	**6.0**
Disposals		(3.9)	-	-	-	**(3.9)**
Impairment	9	-	(0.6)	(1.9)	(0.1)	**(2.6)**
Re-classified as held-for-sale		(3.9)	-	-	-	**(3.9)**
Transfer between categories		(2.9)	5.9	7.3	(10.3)	**-**
At the end of the year		**5.4**	**19.9**	**46.2**	**0.3**	**71.8**
Accumulated depreciation						
At the beginning of the year		6.2	-	25.6	-	**31.8**
Charge for the year	9	0.3	1.3	3.0	-	**4.6**
Disposals		(3.9)	-	-	-	**(3.9)**
Impairment	9	-	(0.5)	(0.7)	-	**(1.2)**
Re-classified as held-for-sale		(0.3)	-	-	-	**(0.3)**
Transfer between categories		(1.4)	2.0	(0.6)	-	**-**
At the end of the year		**0.9**	**2.8**	**27.3**	**-**	**31.0**
Net book value						
At the end of the year		**4.5**	**17.1**	**18.9**	**0.3**	**40.8**
At the beginning of the year		9.9	14.6	15.1	4.8	44.4

2017	Note	Group and Bank Land and buildings	Leasehold improvements	Computers and other equipment	Assets in the course of construction	Total
Cost						
At the beginning of the year		22.0	-	35.6	9.3	66.9
Additions		3.5	-	0.2	17.1	20.8
Disposals		(3.6)	-	-	-	(3.6)
Impairment	9	-	-	-	(0.5)	(0.5)
Merger fair value write off[1]		(1.1)	-	-	-	(1.1)
Write off of fully depreciated assets		-	-	(2.8)	-	(2.8)
Re-classified as held-for-sale		(3.5)	-	-	-	(3.5)
Transfer between categories		(1.2)	14.6	7.7	(21.1)	-
At the end of the year		16.1	14.6	40.7	4.8	76.2
Accumulated depreciation						
At the beginning of the year		8.0	-	23.5	-	31.5
Charge for the year	9	0.5	-	3.7	-	4.2
Disposals		-	-	-	-	-
Merger fair value write off[1]		(0.4)	-	-	-	(0.4)
Write off of fully depreciated assets		-	-	(2.8)	-	(2.8)
Re-classified as held-for-sale		(0.7)	-	-	-	(0.7)
Transfer between categories		(1.2)	-	1.2	-	-
At the end of the year		6.2	-	25.6	-	31.8
Net book value						
At the end of the year		9.9	14.6	15.1	4.8	44.4
At the beginning of the year		14.0	-	12.1	9.3	35.4

1. The remaining Britannia merger fair value was written off in 2017. Refer to note 34 to the consolidated financial statements in the 2017 Annual Report and Accounts for further information.

	Group and Bank	
	2018	2017
The net book value of land and buildings comprises:		
Freehold	**4.5**	8.5
Leasehold	**-**	1.4
	4.5	9.9

21. Intangible assets

		Group and Bank					
		2018			2017		
	Note	**Internally generated intangible assets**	**Other intangible assets**	**Total**	Internally generated intangible assets	Other intangible assets	Total
Cost							
At the beginning of the year		**162.6**	**15.3**	**177.9**	162.8	41.8	204.6
Additions		**18.4**	**-**	**18.4**	18.0	4.3	22.3
Impairment	9	**(0.8)**	**-**	**(0.8)**	(3.1)	-	(3.1)
Merger fair value write off[1]		**-**	**-**	**-**	-	(41.8)	(41.8)
Write off of fully amortised assets		**1.0**	**-**	**1.0**	(4.1)	-	(4.1)
Transfer between categories		**(0.3)**	**0.3**	**-**	(11.0)	11.0	-
At the end of the year		**180.9**	**15.6**	**196.5**	162.6	15.3	177.9
Accumulated amortisation and impairment							
At the beginning of the year		**89.7**	**6.7**	**96.4**	73.5	31.0	104.5
Charge for the year	9	**23.8**	**2.9**	**26.7**	24.3	6.9	31.2
Merger fair value write off[1]		**-**	**-**	**-**	-	(35.2)	(35.2)
Write off of fully amortised assets		**1.0**	**-**	**1.0**	(4.1)	-	(4.1)
Transfer between categories		**-**	**-**	**-**	(4.0)	4.0	-
At the end of the year		**114.5**	**9.6**	**124.1**	89.7	6.7	96.4
Net book value							
At the end of the year		**66.4**	**6.0**	**72.4**	72.9	8.6	81.5
At the beginning of the year		72.9	8.6	81.5	89.3	10.8	100.1

1. The remaining Britannia merger fair value was written off in 2017. Refer to note 34 to the consolidated financial statements in the 2017 Annual Report and Accounts for further information.

Internally generated assets include £11.0m (2017: £18.1m) of assets in the course of construction.

Other intangible assets wholly consist of purchased software licences.

22. Deposits by banks

	Group and Bank	
	2018	2017
Deposits from other banks[1]	**1,433.5**	1,122.7

1. Obligatory netting arrangements are in place for repos and reverse repos transactions. As a result the amount reduced by netting is £100.0m (2017: £300.0m), with the opposing impact in Loans and advances to banks in note 13 to the consolidated financial statements.

Included within deposits from other banks are liabilities of £468.8m (2017: £1,120.5m) secured on investment securities with a carrying value of £470.7m (2017: £1,206.3m) which have been sold under sale and repurchase agreements.

The Group has undertaken a £960.0m drawing of the Bank of England's Term Funding Scheme in February 2018. The Group is obliged to repay this borrowing by February 2022.

23. Debt securities in issue

Debt securities in issue comprise a secured covered bond of £600.0m at a coupon of 4.75%, having a maturity date in November 2021 and requires the Group to pay interest annually and repay contractual amounts due on the specified maturity date.

24. Other liabilities

	Group and Bank	
	2018	2017
Amounts falling due within one year:		
ATM creditor	**-**	3.1
Other creditors	**89.3**	27.1
Amounts falling due after one year:		
Other creditors	**2.8**	4.5
Total other liabilities	**92.1**	34.7

Other creditors include finance lease obligations as follows:

	Group and Bank			
	Present value of lease payments		Future minimum lease payments	
	2018	2017	**2018**	2017
Due between one year and five years	**0.1**	0.1	**0.1**	0.1
Due after five years	**1.0**	1.2	**1.4**	1.4
	1.1	1.3	**1.5**	1.5

The future minimum lease payments have been discounted at LIBOR (London Interbank Offered Rate) over the term of the lease to give the present value of these payments.

25. Accruals and deferred income

	Group and Bank	
	2018	2017
Amounts falling due within one year:		
Accruals	**41.4**	50.3
Deferred income	**6.7**	6.7
	48.1	57.0
Amounts falling due after one year:		
Accruals	**6.9**	8.6
Deferred income	**8.0**	14.4
	14.9	23.0
Total accruals and deferred income	**63.0**	80.0

26. Provisions

		Group and Bank						
2018	Note	**Property**	**FSCS levies**	**PPI**	**Conduct/ legal**	**Separation**	**Other**	**Total**
At the beginning of the year		21.5	2.4	88.9	32.9	-	12.5	**158.2**
Provided/(released) in the year:								
Operating expenses	9	-	(1.6)	-	(0.4)	-	13.9	**11.9**
Net customer redress charge/(release)		-	-	39.5	(5.3)	-	-	**34.2**
Transfer between provision categories[1]		-	-	-	(1.3)	-	1.3	**-**
Utilised during the year		(5.8)	(0.8)	(60.6)	(17.2)	-	(16.3)	**(100.7)**
At the end of the year		**15.7**	**-**	**67.8**	**8.7**	**-**	**11.4**	**103.6**
Provisions were analysed as follows:								
Amounts falling due within one year		9.4	-	66.5	7.1	-	11.4	**94.4**
Amounts falling due after one year		6.3	-	1.3	1.6	-	-	**9.2**
Total provisions		**15.7**	**-**	**67.8**	**8.7**	**-**	**11.4**	**103.6**

1. Transfers made in the year comprised the Customers who Care VISA Flows provision in order to better reflect the nature of the provision.

		Group and Bank						
2017	Note	Property	FSCS levies	PPI	Conduct/ legal	Separation	Other	Total
At the beginning of the year		32.7	6.6	90.4	78.9	27.3	40.5	276.4
Provided/(released) in the year:								
Interest income		-	-	-	0.4	-	-	0.4
Operating expense	9	(0.3)	-	-	1.0	(4.0)	19.9	16.6
Net customer redress charge/(release)		-	-	38.5	(11.5)	-	-	27.0
Utilised during the year		(10.9)	(4.2)	(40.0)	(35.9)	(23.3)	(47.9)	(162.2)
At the end of the year		21.5	2.4	88.9	32.9	-	12.5	158.2
Provisions were analysed as follows:								
Amounts falling due within one year		12.4	2.4	50.0	29.2	-	12.1	106.1
Amounts falling due after one year		9.1	-	38.9	3.7	-	0.4	52.1
Total provisions		21.5	2.4	88.9	32.9	-	12.5	158.2

Property

The Group has a number of leasehold properties available for rent. Provisions are made when either the sub-lease income does not cover the rental expense or the property is vacant. The provision is based on the expected outflows during the remaining periods of the leases. In addition, dilapidation provisions are recorded to the extent that the Group 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 Group has paid 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 was funded through loans from HM Treasury. The Group had previously provided for its estimated share of interest levies based on its market participation.

During the year the FSCS loan balance with HM Treasury for the Bradford and Bingley claims was repaid in full. On 1 October 2018 the FSCS made the final payment of interest accrued up to the date of the loan repayment. As a result of the repayment of the interest by the FSCS to HM Treasury, there will be no further interest levies in relation to this. The Group has therefore released the remaining £1.6m in the year, bringing the provision balance to £nil.

Payment Protection Insurance (PPI)

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

An additional provision of £39.5m was recognised in the year (2017: £38.5m), in respect of the total expected cost of carrying out work and paying compensation related to historical selling of PPI. The additional provision reflects increased complaint volumes ahead of the FCA imposed time-bar of August 2019, the impact of marketing campaigns and the requirement to mail certain previously rejected complaints. As a result, the total provision recognised to date is £537.8m.

Conduct/legal provisions

The Group released £5.3m (net) in the year (2017: £11.5m) for other customer redress charges. Included in the net release is a charge of £4.1m (2017: £nil) relating to possible mischarge of interest for further advances on mortgage products. Releases made during the year mainly comprise £1.9m (2017: £9.6m) for the mortgage remediation projects which were completed during the year and £1.5m in respect of Packaged Bank Accounts (2017: £nil) as the proactive remediation work is nearing completion.

Other

Other provisions include a net charge of £13.9m (2017: £19.9m) which mainly comprises movements in the bonus and severance costs provisions during the year.

27. Deferred tax

Deferred taxes are calculated on all temporary differences under the liability method using the most appropriate tax rate in respect of each temporary difference.

The UK corporation tax rate will reduce from 19% to 17% effective from 1 April 2020. A banking surcharge tax of 8% also applies to the Bank Company. Deferred tax has been calculated by reference to the most appropriate rate based on forecasts.

The movements in deferred tax are as follows:

	Group and Bank					
	2018			2017		
	Deferred tax asset	**Deferred tax liability**	**Total**	Deferred tax asset	Deferred tax liability	Total
Deferred tax at the beginning of the year	4.2	(0.2)	4.0	-	(14.2)	(14.2)
Credited/(charged) to the income statement:						
Current year	**76.6**	**-**	**76.6**	13.3	14.0	27.3
Impact of corporation tax rate charge	**(5.7)**	**-**	**(5.7)**	(2.2)	-	(2.2)
	70.9	**-**	**70.9**	11.1	14.0	25.1
Credited/(charged) to other comprehensive income:						
Cash flow hedges	**3.3**	**-**	**3.3**	8.8	-	8.8
FVOCI/available-for-sale	**0.5**	**-**	**0.5**	4.6	-	4.6
Retirement benefits	**(76.0)**	**(38.7)**	**(114.7)**	(20.3)	-	(20.3)
	(72.2)	**(38.7)**	**(110.9)**	(6.9)	-	(6.9)
Deferred tax at the end of the year	**2.9**	**(38.9)**	**(36.0)**	4.2	(0.2)	4.0

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

	Group and Bank			
	2018		2017	
	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	**94.6**	**-**	59.6	-
Tax losses carried forward	**42.2**	**-**	4.2	-
Retirement benefits	**(117.1)**	**(38.7)**	(39.4)	-
Cash flow hedges	**(6.7)**	**-**	(10.0)	-
Unrealised appreciation on investments	**(6.7)**	**-**	(6.2)	-
FVOCI/available-for-sale	**(3.4)**	**-**	(4.0)	-
Fair value adjustment - The Co-operative Bank subsidiaries	**-**	**(0.2)**	-	(0.2)
	2.9	**(38.9)**	4.2	(0.2)

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

	Group and Bank	
	2018	2017
Tax losses carried forward	**(38.0)**	(4.2)
Capital allowances on fixed assets and assets leased to customers	**(35.1)**	(22.4)
Retirement benefits	**1.7**	14.1
Unrealised appreciation on investments	**0.5**	0.1
Fair value adjustment - The Co-operative Bank subsidiaries	**-**	(11.5)
Cash flow hedges	**-**	1.3
Other temporary differences	**-**	(2.5)
	(70.9)	(25.1)

Deferred tax assets totalling £364.8m (2017: £412.3m) have not been recognised where doubt exists over the availability of sufficient future taxable profits. Deferred tax of £358.4m (2017: £372.8m) and £6.4m (2017: £39.5m) has not been recognised in respect of trading losses of £2,015.0m (2017: £2,069.2m) and other temporary differences of £25.6m (2017: £158.1m) respectively.

28. Retirement benefits

The Group is the principal employer of the Bank section of The Co-operative Pension Scheme (Pace), a hybrid scheme, consisting of a closed defined benefit element (Pace Complete) and a defined contribution element (Pace DC). In addition, the Group is the principal employer in the Britannia Pension Scheme (BPS) which is a defined benefit scheme, closed to new entrants and to future accrual. The Group operates two unfunded defined benefit pension schemes, the Britannia Supplementary Pension and Life Assurance Plan (BSPLAP) and the Pension Promise. The relevant disclosures have been aggregated with the disclosures of the main schemes unless otherwise stated.

Pensions charge

The amounts (charged)/credited to the income statement are as follows:

		Group and Bank	
	Note	**2018**	2017
Interest expense on defined benefit obligation		**(33.0)**	(21.1)
Interest income on plan assets		**43.9**	21.7
Total net interest income	6	**10.9**	0.6
Administrative expenses included in operating expenses		**(2.7)**	(2.3)
GMP equalisation – past service cost	2,10	**(12.4)**	-
Gain on pension scheme modification[1]		**-**	51.9
Net (charge)/credit to the income statement – DB		**(4.2)**	50.2
Net charge (contribution and interest) to the income statement – DC	6,10	**(7.6)**	(7.9)
Total pension (charge)/credit included in the income statement		**(11.8)**	42.3

1. In the prior year, the index used to determine inflationary increases for pensions in payment in BPS was amended to CPI from RPI. This was considered to be a plan amendment and accordingly resulted in a non-recurring gain in the income statement.

The amounts recognised in other comprehensive income are as follows:

	Group and Bank	
	2018	2017
Return on scheme assets	**60.2**	(21.2)
(Gain)/loss arising from changes in financial assumptions	**(46.6)**	35.7
Loss/(gain) arising from changes in demographic assumptions	**24.6**	(55.9)
Experience loss/(gain)	**32.0**	(39.7)
Actuarial loss on unfunded schemes	**(0.7)**	(0.5)
Charge/(credit) recorded in other comprehensive income	**69.5**	(81.6)

The amounts recognised in the balance sheet are as follows:

	Group and Bank	
	2018	2017
Retirement benefit assets	**623.5**	157.7
Retirement benefit liabilities	**(7.6)**	(11.3)
Total amounts recognised in the balance sheet	**615.9**	146.4
Represented by:		
Funded DB schemes (Pace Complete and BPS)	**623.5**	157.7
Unfunded DB schemes	**(7.6)**	(8.4)
Liability for contributions to DC scheme (Pace DC)	**-**	(2.9)
Total amounts recognised in the balance sheet	**615.9**	146.4

Defined benefit schemes

a) Characteristics of the defined benefit plans and risks associated with them

Both the Pace Complete and the BPS defined benefit schemes are based in the UK. Pace Complete closed to new entrants and to future accrual in October 2015. The benefits that had accrued until that point were on a career average revalued earnings basis, meaning that benefits earned by a member were dependent on the length of service and the average earnings over the length of service. BPS closed to new entrants in 2001 and to future accrual on 6 October 2012. Annual increases on pensions in payment for both Pace Complete and BPS are applied in line with their respective scheme rules.

Given both schemes are closed to new entrants and accrual, the certainty over pension liabilities increases over time and this increased certainty is reflected in the investment strategies (noted below). Pension obligations are valued separately for accounting and funding purposes. The accounting valuation of liabilities is prepared biannually for Group's reporting purposes by a qualified actuary. This accounting position of pension obligations is combined with the fair value of plan assets to give the net asset or liability in respect of DB pensions at the balance sheet date for the Group's financial reporting purposes. The funding valuation is conducted by the trustee, in consultation with the Group, and is conducted by a qualified actuary at least once every three years (and is updated for monitoring purposes to the scheme's financial year end on

an annual basis). The latest actuarial funding valuations were conducted in respect of Pace Complete as at April 2016 and for BPS as at April 2017. A valuation exercise was also undertaken for Pace Complete as at December 2017 as part of the project to sectionalise the scheme (please see section 1.4.11 for more information).

The purpose of the funding valuation is to judge the amount of cash an employer needs to contribute to the scheme. The funding valuation will generally be different to the accounting valuation, not only because of the different measurement dates, but also because accounting standards require that companies employ best estimate assumptions, and therefore the accounting surplus will generally be higher than that reported in the more prudent funding valuation. The Group has recognised a net pension asset of £477.4m in respect of Pace Complete for the year ended 31 December 2018 (2017: £nil). The prior year net asset was not recognised due to the fact that the scheme was not sectionalised until 2018 which was the point at which the Group could reliably calculate its share of plan assets and liabilities. The Group has recognised a net pension asset of £146.1m for BPS (2017: £157.7m).

Funding position of Pace Complete

At the last funding valuation, Pace Complete was not sectionalised and the surplus for the whole scheme at April 2016 was £251.0m. As part of the project to sectionalise Pace, it was agreed that a more prudent funding measure would be applied to the Bank section post-sectionalisation than to other employers. As a result, it was agreed with the Pace trustee and Co-operative Group that the Bank would contribute £100m into the Bank section of Pace over a ten-year period from 1 January 2018. In addition, the Bank would provide security to Pace in the form of £276.9m AAA rated retained RMBS notes, with a 22% haircut, decreasing over time in line with contributions paid into the Bank section. This security becomes enforceable in the event that deficit recovery payments are not met, as agreed with the trustee, insolvency or the failure to adhere to the terms of the security deed.

Contributions are also paid in respect of employed members of the defined contribution section of Pace. Members can choose to pay up to a maximum core contribution of 8% of salary ‘double-matched’ up to a maximum member contribution of 5%. So, for members paying 5% or more, an employer contribution of 10% of salary is paid into the scheme.

Funding position of BPS

The actuarial valuation of BPS as at 5 April 2017, completed by the scheme actuary in accordance with the scheme specific funding requirements of the Pensions Act 2004, showed BPS had a surplus of £1.7m. As a result, it was agreed with the trustee that no further deficit recovery contributions would be required at this time; however, the provision of security to the scheme was agreed to be maintained. This security is in the form of £165.1m AAA rated retained RMBS notes, with a 17% haircut. This security becomes enforceable in the event that deficit recovery payments are not met, as agreed with the trustee, insolvency or the failure to adhere to terms of the security deed.

The responsibility for the governance of the schemes lies with their respective trustees. Pace Trustees Limited is the corporate body that acts as trustee of the Pace scheme including Pace Complete and Pace DC. Britannia Pension Trustees Limited is the corporate body that acts as trustee of the Britannia scheme. The main risks impacting the pension obligations are inflation risk, interest rate risk and mortality (or longevity) risk. In respect of both schemes, the majority of inflation risk and interest rate risk is hedged through the investment strategy to invest in Liability-Driven Investments (LDI) which include derivatives. If the value of liabilities were to increase as a result of increased inflation or a change in interest rates, the value of these LDI assets would also increase. The actual mortality rates experienced by the scheme compared to those assumed by the actuary is a key source of estimation uncertainty. The actuary considers two aspects in respect of mortality rates, firstly the level of mortality actually experienced by each scheme and secondly, the future improvement expected in mortality rates. Both aspects may differ between males and females. The assumptions used by the actuary are set out in section b) below. The trustee of Pace is currently undertaking a study of mortality rates, the results of which are still under discussion at the date of this report.

The performance of plan assets is also a risk managed by the trustees (described as investment risk) and, as noted within the investment strategy, the performance is managed and monitored by comparison to scheme benchmarks advised by the scheme’s investment advisor. The benchmarks take account of actual performance by comparing performance to that of a relevant comparable yardstick. For LDI assets, the performance benchmark comparison is the value of liabilities. For return-seeking investments the benchmark is comprised of comparable investment indices. The trustees also monitor whether performance is being delivered by taking on greater risk than appetite; this is monitored by comparing the actual asset allocation to the target allocation agreed by the trustees. The weighted average duration of the defined benefit obligation of BPS is 19 years and 20 years for Pace Complete.

b) Summary of scheme assets and liabilities, key assumptions and sensitivities
As explained in section a) to this note, Pace Complete was brought on balance sheet during 2018 following sectionalisation of the scheme.

The pension assets and liabilities for DB schemes in the balance sheet comprise:

	Group and Bank					
	2018			2017		
Schemes	**Asset**	**Liability**	**Net**	Asset	Liability	Net
Pace Complete	**1,862.5**	**1,385.1**	**477.4**	-	-	-
Britannia Pension Scheme	**740.6**	**594.5**	**146.1**	792.6	634.9	157.7
Total schemes	**2,603.1**	**1,979.6**	**623.5**	792.6	634.9	157.7

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

	Group and Bank	
	2018	**2017**
Defined benefit obligation at the start of the year	**634.9**	834.6
Past service cost	**12.4**	(51.9)
Interest expense	**33.0**	21.1
Benefit payments from plan assets	**(107.0)**	(108.9)
Remeasurements:		
Effect of changes in demographic assumptions	**24.6**	(55.9)
Effect of changes in financial assumptions	**(46.6)**	35.7
Effect of experience assumptions	**32.0**	(39.8)
Liabilities recognised on recognition of Pace Complete	**1,396.3**	-
Defined benefit obligation at the end of the year	**1,979.6**	634.9

The key assumptions used to determine the funded and unfunded pension obligations for accounting purposes are set out in the following tables:

	Group and Bank	
	2018	**2017**
Discount rate	**2.80%**	2.40%
Revaluation in deferment (CPI)	**2.10%**	2.10%
Future pension increases where capped at 5.0% per annum (CPI)	**2.10%**	2.10%
Future pension increases where capped at 5.0% per annum, minimum 3.0% (CPI)	**3.20%**	3.20%
Future pension increases where capped at 6.0% per annum (RPI)	**3.20%**	N/A
Future pension increases where capped at 5.0% per annum (RPI)	**3.10%**	N/A
Future pension increases where capped at 3.0% per annum (CPI)	**1.90%**	N/A
Future pension increases where capped at 2.5% per annum (RPI)	**2.20%**	N/A

The average life expectancy (in years) for mortality tables used to determine defined benefit schemes liabilities at the 2018 year end is:

	Male	**Female**
Life expectancy (BPS):		
Member retiring today (member age 60)	86.3	88.4
Member retiring in 20 years (member age 40 today)	87.6	89.7
Life expectancy (Pace):		
Member retiring today (member age 60)	86.7	88.3
Member retiring in 20 years (member age 40 today)	87.8	89.6

The measurement of the Group's defined benefit liability is particularly sensitive to changes in certain key assumptions, which are described below. The methods used to carry out the sensitivity analyses presented below for the material assumptions are the same as those the Group has used previously. The calculations alter the relevant assumption by the amount specified, whilst assuming that all other variables remained the same. This approach is not necessarily realistic, since some assumptions are related; for example, if the scenario is to show the effect if inflation is higher than expected, it might be reasonable to expect that nominal yields on corporate bonds will increase also. However, it enables the reader to isolate one effect from another.

Discount rate	This has been selected following actuarial advice received by the Group, taking into account the duration of the liabilities. An increase in the discount rate of 0.1% would result in a £34.4m decrease in the present value of the defined benefit obligation.
Inflation	Inflation is a significant assumption as it is used to determine salary-related benefits and pension increases before and after retirement. A decrease in the inflation rate of 0.1% would result in a £26.7m decrease in the present value of the defined benefit obligation.
Mortality rates	The mortality assumptions adopted are based on those recommended by the actuaries that advise the scheme management and reflect the most recent information as appropriate. The impact on the liability if members were assumed to live for one year longer against the current mortality assumption would increase the present value of the defined benefit obligation by £88.7m.

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

	Group and Bank	
	2018	**2017**
Fair value of plan assets at the start of the year	**792.6**	854.9
Interest income	**43.9**	21.7
Employer contributions	**11.3**	6.0
Benefit payments from plan assets	**(107.0)**	(108.9)
Administrative expenses paid from plan assets	**(2.7)**	(2.3)
Return on plan assets (excluding interest income)	**(60.2)**	21.2
Asset recognised on recognition of Pace Complete	**1,925.2**	-
Fair value of plan assets at the end of the year	**2,603.1**	792.6

c) Investment strategy for the DB schemes

The investment strategy is controlled by the trustee of each scheme in consultation with the participating employers. The investment objective is to invest each scheme's assets in the best interest of the members and beneficiaries, and in the case of a potential conflict of interest, in the sole interest of the members and beneficiaries. Within this framework the trustees have agreed a number of objectives to help guide in the strategic management of the assets and control of the various risks to which each scheme is exposed. Primary objectives are as follows:

- Agree to implement an investment strategy that initially targets an expected return of around 1.2% p.a. (net of fees) above the return on a portfolio of gilts for BPS and around 0.5% p.a. (net of fees) above the return on a portfolio of gilts for Pace Complete.
- The primary objective is that each scheme has sufficient and appropriate assets to meet the costs incurred by the trustee in paying its benefits as they fall due on a technical provisions basis (technical provisions being the funding valuation basis reflecting a prudent valuation).
- If funding improves as a result of better than expected investment returns; the expectation is to use the opportunity to reduce investment risk where appropriate

In 2018, both Pace Complete and BPS were in the process of updating their investment strategies to reflect the closed nature of the schemes, the consequential ageing (and therefore increased predictability of liabilities) and the latest economic outlook. The trustees agreed to make a number of changes to the strategic asset allocation targets, reducing the level of return-seeking assets and increasing the level of assets which mitigate against funding volatility. These changes were in line with the trustee's stated desire of increasing the predictability of investment returns where possible. At any point in time, the implemented asset portfolio may not exactly match the target asset portfolio, in particular during a time of change to the target. This difference between the actual and target asset allocation is monitored regularly by the trustees.

The fair value of the DB schemes' assets is analysed as follows:

	Group and Bank			
	2018	**% of total**	2017	% of total
Fixed interest government bonds	**442.6**	**17%**	5.9	1%
Index linked government bonds	**726.3**	**28%**	219.9	28%
Corporate bonds	**35.7**	**1%**	-	-
Derivatives	**33.3**	**1%**	-	-
Cash and similar	**64.5**	**3%**	6.1	1%
Other	**13.2**	**1%**	15.2	2%
Total liability driven investment (LDI) portfolios	**1,315.6**	**51%**	247.1	32%
Equity instruments	**-**	**-**	97.8	12%
Debt instruments	**401.3**	**15%**	244.8	31%
Investment funds	**40.3**	**1%**	114.2	14%
Investment grade credit	**662.8**	**26%**	-	-
Asset backed securities	**64.0**	**2%**	-	-
Property funds (UK)	**67.8**	**3%**	64.7	8%
Cash and other	**51.3**	**2%**	24.0	3%
Total assets	**2,603.1**	**100%**	792.6	100%

The table below shows the value of the assets in each category which have a quoted market price:

	Group and Bank	
	2018	2017
Quoted equities	**-**	97.8
Liability driven investments	**1,254.8**	247.1
Debt instruments	**321.0**	179.2
Other	**678.8**	24.0
Total	**2,254.6**	548.1
Total %	**87%**	69%

The scheme assets do not directly include any of the Group's own assets, nor any property occupied, or other assets used by, the Group. Where available, the fair values are quoted prices (e.g. listed equity, sovereign debt and corporate bonds). Unlisted investments are included at values provided by the fund manager in accordance with relevant guidance. Other significant assets are valued based on observable inputs such as yield curves.

29. Contingent liabilities

The tables below provide the contractual amounts and risk weighted amounts of contingent liabilities and commitments. The contractual amounts indicate the volume of business outstanding at the balance sheet date and do not represent amounts at risk. The risk weighted amounts have been calculated in accordance with the CRD IV rules.

The contingent liabilities, as detailed below, arise in the normal course of banking business and it is not practical to quantify their future financial effect.

	Group and Bank			
	Audited	**Unaudited**	Audited	Unaudited
	Contractual amount 2018	**Risk weighted amount 2018**	Contractual amount 2017	Risk weighted amount 2017
Contingent liabilities arising from customer transactions:				
Guarantees and irrecoverable letters of credit	**12.4**	**3.7**	15.4	5.3
Other commitments arising from customer transactions:				
Undrawn formal standby facilities, credit lines and other commitments to lend (includes revocable and irrevocable commitments)[1]	**2,123.0**	**236.2**	2,263.2	265.3
	2,135.4	**239.9**	2,278.6	270.6

1. Undrawn loan commitments include revocable commitments which are unused credit card limits of £1,097.1m (2017: £1,211.2m).

Holding company B shareholders

There is a contingent liability of £25.0m in aggregate due to B shareholders on exit, subject to achieving a minimum valuation threshold. See note 4 for the Holding Company.

Assets pledged

Assets are pledged as collateral under repurchase agreements with other banks. These deposits are not available to finance the day-to-day operations. Mandatory reserve deposits are also held with the Bank of England in accordance with statutory requirements. See note 33 to the consolidated financial statements for further details of assets pledged.

Commitments under operating leases

Various properties and equipment are leased under non-cancellable operating lease arrangements. The leases have various terms, ranging from six months to 999 years. None of these leases are individually material and none have any material clauses. The table below discloses the minimum (undiscounted) operating lease payments that will be required over the remaining lives of the leases.

	Group and Bank	
	Land and buildings 2018	Land and buildings 2017
Falling due:		
Within one year	**9.4**	8.7
Between one and five years	**31.4**	25.8
In five years or more	**49.1**	72.2
	89.9	106.7

A number of branch and office premises are leased under operating leases. The leases typically run for a period of up to 25 years, with an option to renew the lease after that period. Lease payments are generally reviewed every three to five years to reflect market rentals.

The total value of future minimum sub-lease payments expected to be received under non-cancellable sub-leases was £3.2m (2017: £3.1m).

Indemnification agreement
An indemnification agreement exists with CFS Management Services (CFSMS), part of The Co-operative Group, which is accounted for as a guarantee under IFRS 4, in which CFSMS is indemnified against all and any liability, loss, damage, costs and expense arising from the agreement (under which CFSMS provides certain assets and services). This agreement will remain in place until it is terminated by either party, which is likely to be after separation activities with the wider Co-operative Group are fully completed, but if termination is instigated by the Bank then this will require the consent of CFSMS.

Separation costs agreement and IT services agreement
IT services are received from Co-operative Group under an IT Services Agreement (ITSA) dated 5 July 2012. The services are provided on an 'at costs' basis and Co-operative Group is managed as a provider of material services. Notice was received from Co-operative Group on 1 October 2018, terminating services by 30 September 2019. Various IT services have already been transitioned from Co-operative Group to new suppliers and it is intended that remaining services will be transitioned by 30 September 2019.

An IT Separation Costs Agreement was entered into with Co-operative Group on 22 January 2015 as amended by a letter dated 20 June 2016 to support separation of the legacy shared infrastructure. The IT Separation Costs Agreement assessed the Group and Co-operative Group's respective costs to deliver separation. Co-operative Banking Group (as the parent of CFS Management Services Limited) undertook to contribute a maximum of £95.0m towards such Co-operative Group costs, with the Group making a contribution of up to £25.0m, based on a formula in the event that the total cost of this Co-operative Group project falls between £76.0m and £120.0m.

Conduct issues
Given the high level of scrutiny regarding financial institutions' treatment of customers and business conduct from regulatory bodies, the media and politicians, there is a possibility that certain aspects of the current or historic business, including, amongst other things, mortgages and relationship banking, may be determined by the FCA and other regulatory bodies or the courts as, in their opinion, not being conducted in accordance with applicable laws or regulations, or fair and reasonable treatment.

In particular, there is currently a significant regulatory focus on the sale practices and reward structures that financial institutions have used when selling financial products. There may also be other regulatory investigations and action in the future in relation to conduct and other issues that the Group is not presently aware of, including investigations and actions against it resulting from alleged mis-selling of financial products or the ongoing servicing of those financial products. The outcome of any ongoing disputes and legal, regulatory or other investigations or proceedings is currently uncertain.

Sale of the Group's share in Visa Europe Limited (VE)
The sale of the share in VE completed on 21 June 2016. In connection with the transaction, the Group and certain other members of VE have entered into a Loss Sharing Agreement (LSA), on a several and not joint basis, to indemnify Visa Inc. (VI) for certain losses which may be incurred as a result of existing and potential litigation relating to the setting and implementation of domestic Merchant Interchange Fee (MIF) rates in the UK. This indemnification is up to a maximum amount of the upfront cash consideration received, being approximately €50.0m. For any such losses, the arrangement under the LSA will replace the potential uncapped indemnity under the existing VE operating regulations, which will otherwise continue for claims outside the UK. The Preference Stock, the LSA, and the continuation of the existing indemnity for claims outside the UK work together to provide Visa Inc. with protection against liabilities from MIF litigation in the VE territory. Overall losses would in the first instance be recovered by VI from the banks in the form of cancelling the preference shares issued as part of the consideration above.

The potential exists, therefore, for the value of the consideration in the form of preference shares (Preference Stock) to be eroded by liabilities incurred by Visa Inc. in connection with MIF litigation in the VE territory. For further fair value disclosures see note 33 to the consolidated financial statements.

Regulatory supervision and other investigations
There are a number of regulatory supervision investigations and enquiries into events and circumstances surrounding them, including the following:

- The Treasury announced on 6 March 2018 the expected commencement of an independent review pursuant to their powers under the Financial Services Act 2012 into the prudential supervision of the Bank relating to the period 2008-2013.
- The Financial Reporting Council (FRC) has launched an investigation under its Accountancy Scheme into the preparation, approval and audit of the Bank's accounts up to and including its 2012 annual accounts, which focuses on the role of the previous auditors and individual accountants. The investigation in relation to previous auditors and the audit of the 2012 and prior financial statements is ongoing.

The Bank has been and will continue to co-operate with the investigating authorities. It is not possible to estimate the financial impact should any adverse findings be made.

Legal proceedings
Various other legal proceedings exist involving claims by and against the Bank, which arise in the ordinary course of business, including debt collection, mortgage enforcement, consumer claims and contractual disputes. It is not expected that the ultimate resolution of any of these proceedings will have a material adverse effect on the operating results, cash flows or the financial position and contingent liabilities have not been disclosed for these claims. Provisions have been recognised for those cases where there is an ability to reliably estimate the probable loss where the probable loss is not de minimis. See note 26 to the consolidated financial statements.

Mortgage securitisation representations and warranties (including Warwick Finance One, Two and Three)
In connection with the mortgage securitisations (including Warwick Finance One, Two and Three) and covered bond transactions, various representations and warranties relating to the mortgage loans are made, including in relation to ownership, compliance with legislation and origination procedures. If the representations and warranties are breached subject to any applicable materiality determination, repurchase of the affected mortgage loans or in some circumstances compensation to the securitisation vehicle may be required. As part of the original mortgage securitisation transaction for Warwick Finance One, Two and Three, the Bank transferred to the SPEs a contribution to fund redress for certain conduct issues. As at 31 December 2018, the remaining unutilised contribution was due to the Group following the conclusion of certain remediation programmes.

There is a risk that a number of the underlying matters giving rise to the conduct and legal provisions set out in note 26 to the consolidated financial statements could have given rise to breaches of such representations and warranties. Accordingly, there is a risk that compensation or repurchasing affected mortgage loans may be required in amounts that may reduce liquidity.

The extent cannot be estimated to which the matters described above, will be impacted, or how future developments may have a material adverse impact on the Group's net assets, operating results or cash flows in any particular period.

30. Investment in joint ventures
Investment in joint ventures is £nil (2017: £6.3m).

In June 2018, the Bank Company sold its shares in Britannia Personal Lending Limited (BPL) to Bank of Scotland plc, at a profit of £0.2m.

50% of the ordinary shares are owned in Britannia New Homes (Scotland) Limited (BNH(S)), registered in England and operating in the UK. BNH(S) trades in the construction of domestic buildings and is considered a joint venture as decisions about relevant activities require the unanimous consent of joint venturers and this is accounted for as such. Britannia New Homes (Scotland) Limited has negative net assets (£0.9m) and therefore the 50% retained proportion is capped at £nil to align to the carrying value of cost of investment in the entity.

31. Related party transactions

Parent, subsidiary and ultimate controlling party
As at 31 December 2018, the Group had two significant shareholders: SP Coop Investment Ltd and Anchorage Illiquid Opportunities Offshore Master V, L.P, each holding over 20% of the B shares of the Holding Company, and therefore considered to be related parties.

Transactions with other related parties
The Bank's definition of Key Management Personnel has been expanded in 2018 to include the Executive Committee of the Group and Bank, having previously been defined as the Board Directors of the Group and Bank. Accordingly, aggregate remuneration has increased along with an increase in the number of Key Management Personnel compared to 2017.

The related party transactions with key management are disclosed below:

	Group and Bank	
	2018	2017
Deposits and investments at the beginning of the year	**0.1**	1.2
Net movement	**0.5**	(1.1)
Deposits and investments at the end of the year	**0.6**	0.1

Key management personnel

	Group and Bank	
	2018	2017
Total remuneration receivable by key management personnel	**11.1**	5.3

In 2018, the total number of Key Management Personnel was 27 (2017: 11). Further information about the remuneration of senior management personnel and material risk takers is included in the directors' remuneration report, which includes Key Management Personnel.

32. Share capital and capital re-organisation reserve

a) Share capital

	Group			
	2018		2017	
	No. of shares (millions)	**Share capital**	No. of shares (millions)	Share capital
Allotted, called up and fully paid				
At the beginning of the year	**9,029.1**	**0.9**	451.5	22.6
Issued during the year	**-**	**-**	9,029.1	0.9
Share for share exchange	**-**	**-**	(451.5)	(22.6)
At the end of the year	**9,029.1**	**0.9**	9,029.1	0.9
Share premium account				
At the beginning of the year		**313.8**		1,736.9
Premium on shares issued during the year		**-**		313.8
Share for share exchange		**-**		(1,736.9)
At the end of the year		**313.8**		313.8

There are 9,029,130,200 A shares (2017: 9,029,130,200) and 82 B shares (2017: 65) in the Co-operative Bank Holdings Limited following the Restructuring and Recapitalisation in 2017. The holders of the ordinary A shares do not hold any voting rights but are entitled to participate in distributions and to receive a dividend on liquidation. The B shareholders have one vote for every share held and also benefit from certain governance, notification and approval rights with respect to the new Holding Company group but will have no rights to distributions, other than on exit in an amount of £25.0m in aggregate, subject to achieving a minimum valuation threshold.

	Bank			
	2018		2017	
	No. of shares (millions)	**Share capital**	No. of shares (millions)	Share capital
Allotted, called up and fully paid				
At the beginning of the year	**511.5**	**25.6**	451.5	22.6
Issued during the year	**-**	**-**	60.0	3.0
At the end of the year	**511.5**	**25.6**	511.5	25.6
Share premium account				
At the beginning of the year		**2,416.9**		1,736.9
Premium on shares issued during the year		**-**		680.0
At the end of the year		**2,416.9**		2,416.9

The Bank's existing ordinary shares were transferred to the ownership of The Co-operative Bank Holdings Limited as part of the 2017 Restructuring and Recapitalisation. The number of ordinary shares in issue in the Bank Company at 31 December 2018 was 511,456,510 (2017: 511,456,510). The ordinary shareholders have one vote for every share held. Refer to note 35 to the consolidated financial statements for details of a 2019 group reconstruction and related transfer in ownership of The Co-operative Bank plc shares to an intermediary holding company.

b) 2017 Restructuring and Recapitalisation

	Group				
2017	**Profit and loss**	**Share capital**	**Share premium**	**Capital re-organisation reserve**	**Total**
Issuance of shares in exchange for existing debt and contributions	397.8	0.9	313.8	-	**712.5**
Costs associated with Restructuring and Recapitalisation transaction	(41.5)	-	-	(21.8)	**(63.3)**
Total effect of transactions on profit and reserves	**356.3**	**0.9**	**313.8**	**(21.8)**	**649.2**
Reclassification of Bank share capital and share premium	-	(22.6)	(1,736.9)	1,759.5	**-**

The Restructuring and Recapitalisation completed on 1 September 2017 resulted in an increase in the total equity of £649.2m. This amount is stated after deduction of costs and expenses of £63.3m.

The Restructuring and Recapitalisation included the following steps:

- the creation of the Holding Company: the transfer of all the Bank's ordinary shares to the Holding Company in exchange for A shares in the Holding Company implemented by way of the Members' Scheme. As a result of the Restructuring and Recapitalisation the Holding Company now owns 100% of the Bank;
- the exchange of all Subordinated Notes held by Subordinated Noteholders (other than the 2023 Notes held by Retail Noteholders) for A shares in the Holding Company and the Mandatory Cancellation of the 2023 Notes held by Retail Noteholders in consideration of the payment by the Bank of the Retail Cash Consideration to Retail Noteholders; and
- the subscription of an aggregate £250.0m of A shares in the Holding Company, the proceeds of which, together with the release of the Subordinated Notes, were used by the Holding Company to subscribe for shares in the Bank.

In aggregate this resulted in the cancellation of subordinated debt of the Bank with a carrying value of £468.7m in return for shares issued to the Holding Company by Bank and £6.3m of cash paid to Retail Noteholders.

The overall net gain on the Restructuring and Recapitalisation was recorded partly through the income statement and partly through equity, in accordance with IFRS and the Companies Act.

The capital re-organisation reserve was recognised on the issuance of Holding Company shares in exchange for the acquisition of the entire share capital of The Co-operative Bank plc. The reserve reflects the difference between the consideration for the issuance of Holding Company shares and the Bank's share capital and share premium.

The fair value of the Bank implied as part of the Restructuring and Recapitalisation was calculated on the basis that approximately 67.6% of the Holding Company represents the £250.0m of equity capital raise. Scaling this up to 100%, this would then equate to the fair value of the Holding Company and by virtue of the Holding Company having no trading operations of its own, the fair value of the Bank would therefore be equivalent to 100% of the Holding Company.

Bank

The impact of the Retail debt extinguishment and transaction costs on net assets is consistent between Group and Bank and was recorded partly through the income statement and partly through equity as described above, in accordance with IFRS and the Companies Act. The difference between the fair value of the shares issued and the carrying amount of the bonds extinguished has been recognised directly in equity (via share premium), as the loss is borne by the debt holder who is also the shareholder (i.e. the Holding Company) and constitutes a capital contribution.

33. Fair values of financial assets and liabilities

This note has been prepared on a Group basis, however is equally applicable to the Bank.

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.

		Group					
			Measured at fair value				
Balance sheet categories	Note	**Amortised cost**	**FVOCI**	**FVTPL – designated**	**FVTPL – mandatorily measured**	**Derivatives in a hedging relationship**	**Total**
2018							
Assets							
Cash and balances at central banks	12	1,843.8	-	-	-	-	**1,843.8**
Loans and advances to banks	13	485.8	-	-	-	-	**485.8**
Loans and advances to customers	14	17,583.1	-	148.5	2.3	-	**17,733.9**
Investment securities	15	89.1	1,842.4	-	3.5	-	**1,935.0**
Derivative financial instruments	16	-	-	-	130.9	61.3	**192.2**
Equity shares	17	-	-	-	26.4	-	**26.4**
Other assets	18	21.8	-	-	32.9	-	**54.7**
Total financial assets		**20,023.6**	**1,842.4**	**148.5**	**196.0**	**61.3**	**22,271.8**
Non-financial assets							**831.0**
Total assets							**23,102.8**
Liabilities							
Deposits by banks	22	1,433.5	-	-	-	-	**1,433.5**
Customer accounts		18,735.8	-	-	-	-	**18,735.8**
Debt securities in issue	23	617.6	-	-	-	-	**617.6**
Derivative financial instruments	16	-	-	-	144.3	116.3	**260.6**
Other liabilities	24	92.1	-	-	-	-	**92.1**
Total financial liabilities		**20,879.0**	**-**	**-**	**144.3**	**116.3**	**21,139.6**
Non-financial liabilities							**213.1**
Total liabilities							**21,352.7**
Capital and reserves attributable to the Group's equity holders							**1,750.1**
Total liabilities and equity							**23,102.8**

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

Balance sheet categories	Note	Group Held for trading	Designated at fair value	Loans and receivables	Available-for-sale	Liabilities at amortised cost	Derivatives in a hedging relationship	Total
2017[1]								
Assets								
Cash and balances at central banks	12	-	-	4,032.1	-	-	-	4,032.1
Loans and advances to banks	13	-	-	574.8	-	-	-	574.8
Loans and advances to customers	14	3.2	175.0	16,566.3	-	-	-	16,744.5
Investment securities	15	-	-	100.0	2,287.7	-	-	2,387.7
Derivative financial instruments	16	154.9	-	-	-	-	77.5	232.4
Equity shares	17	-	-	-	26.6	-	-	26.6
Other assets	18	-	-	95.3	-	-	-	95.3
Total financial assets		158.1	175.0	21,368.5	2,314.3	-	77.5	24,093.4
Non-financial assets								396.7
Total assets								24,490.1
Liabilities								
Deposits by banks	22	-	-	-	-	1,122.7	-	1,122.7
Customer accounts		-	-	-	-	20,635.0	-	20,635.0
Debt securities in issue	23	-	-	-	-	627.4	-	627.4
Derivative financial instruments	16	173.2	-	-	-	-	141.8	315.0
Other liabilities	24	-	-	-	-	34.7	-	34.7
Total financial liabilities		173.2	-	-	-	22,419.8	141.8	22,734.8
Non-financial liabilities								249.7
Total liabilities								22,984.5
Capital and reserves attributable to the Group's equity holders								1,505.6
Total liabilities and equity								24,490.1

1. In accordance with the transitional provisions in IFRS 9, comparative figures have not been restated. See note 36 to the consolidated financial statements for details of changes in accounting policy.

Balance sheet categories	Note	Bank					
			Measured at fair value				
		Amortised cost	FVOCI	FVTPL – designated	FVTPL – mandatorily measured	Derivatives in a hedging relationship	Total
2018							
Assets							
Cash and balances at central banks	12	1,843.8	-	-	-	-	**1,843.8**
Loans and advances to banks	13	485.8	-	-	-	-	**485.8**
Loans and advances to customers	14	17,583.1	-	148.5	2.3	-	**17,733.9**
Investment securities	15	89.1	1,842.4	-	3.5	-	**1,935.0**
Derivative financial instruments	16	-	-	-	130.9	61.3	**192.2**
Equity shares	17	-	-	-	26.4	-	**26.4**
Other assets	18	21.8	-	-	32.9	-	**54.7**
Total financial assets		**20,023.6**	**1,842.4**	**148.5**	**196.0**	**61.3**	**22,271.8**
Non-financial assets							**831.0**
Total assets							**23,102.8**
Liabilities							
Deposits by banks	22	1,433.5	-	-	-	-	**1,433.5**
Customer accounts		18,735.9	-	-	-	-	**18,735.9**
Debt securities in issue	23	617.6	-	-	-	-	**617.6**
Derivative financial instruments	16	-	-	-	144.3	116.3	**260.6**
Other liabilities	24	92.1	-	-	-	-	**92.1**
Total financial liabilities		**20,879.1**	**-**	**-**	**144.3**	**116.3**	**21,139.7**
Non-financial liabilities							**213.1**
Total liabilities							**21,352.8**
Capital and reserves attributable to the Bank's equity holders							**1,750.0**
Total liabilities and equity							**23,102.8**

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

Balance sheet categories	Note	Bank Held for trading	Designated at fair value	Loans and receivables	Available-for-sale	Liabilities at amortised cost	Derivatives in a hedging relationship	Total
2017[1]								
Assets								
Cash and balances at central banks	12	-	-	4,032.1	-	-	-	4,032.1
Loans and advances to banks	13	-	-	574.8	-	-	-	574.8
Loans and advances to customers	14	3.2	175.0	16,566.3	-	-	-	16,744.5
Investment securities	15	-	-	100.0	2,287.7	-	-	2,387.7
Derivative financial instruments	16	154.9	-	-	-	-	77.5	232.4
Equity shares	17	-	-	-	26.6	-	-	26.6
Other assets	18	-	-	95.3	-	-	-	95.3
Total financial assets		158.1	175.0	21,368.5	2,314.3	-	77.5	24,093.4
Non-financial assets								396.7
Total assets								24,490.1
Liabilities								
Deposits by banks	22	-	-	-	-	1,122.7	-	1,122.7
Customer accounts		-	-	-	-	20,635.1	-	20,635.1
Debt securities in issue	23	-	-	-	-	627.4	-	627.4
Derivative financial instruments	16	173.2	-	-	-	-	141.8	315.0
Other liabilities	24	-	-	-	-	34.7	-	34.7
Total financial liabilities		173.2	-	-	-	22,419.9	141.8	22,734.9
Non-financial liabilities								249.7
Total liabilities								22,984.6
Capital and reserves attributable to the Bank's equity holders								1,505.5
Total liabilities and equity								24,490.1

1. In accordance with the transitional provisions in IFRS 9, comparative figures have not been restated. See note 36 to the consolidated financial statements for details of changes in accounting policy.

a) Use of financial assets and liabilities

The use of financial instruments is essential to the Group's and Bank's business activities, and financial instruments constitute a significant proportion of the balance sheet. The main financial instruments used, 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 Group and Bank, and loans and advances to customers and customer accounts are major constituents of the balance sheets. 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 liquidity requirements and generate incremental net interest income.

- **Deposits by banks**
  Deposits include the drawdown of Bank of England's Term Funding Scheme.

- **Debt securities in issue**
  Notes secured by mortgage assets have been issued through the Covered Bond programmes.

- **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, and are used mainly for hedging purposes and to meet the needs of customers.

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

- **Foreign exchange**
  Foreign exchange dealings are undertaken to facilitate customer requirements and to economically hedge balance sheet exposure to foreign currencies. The risk is managed formally within position limits which are set by the Assets and Liabilities Committee (ALCo), to which authority is delegated by the Board.

b) Valuation of financial assets and liabilities measured at fair value

The carrying values of financial assets and liabilities measured at fair value are determined in compliance with the accounting policies in note 1 to the consolidated financial statements and analysed in the following tables 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

There were no transfers between level 1 and 2 during the year.

	Group and Bank			
	Fair value at end of the reporting period using:			
	Level 1	**Level 2**	**Level 3**	**Total**
2018				
Non-derivative financial assets				
FVOCI:				
Investment securities	1,443.1	-	399.3	**1,842.4**
FVTPL – designated:				
Loans and advances to customers	-	145.7	2.8	**148.5**
FVTPL – mandatorily measured:				
Loans and advances to customers	-	-	2.3	**2.3**
Investment securities	-	-	3.5	**3.5**
Equity shares	0.4	-	26.0	**26.4**
Other assets	-	-	32.9	**32.9**
Derivative financial assets	-	192.2	-	**192.2**
Non-financial assets				
Investment properties	-	-	2.3	**2.3**
Total assets carried at fair value	**1,443.5**	**337.9**	**469.1**	**2,250.5**
Derivative financial liabilities	-	260.6	-	**260.6**
Total liabilities carried at fair value	**-**	**260.6**	**-**	**260.6**

	Group and Bank			
	Fair value at end of the reporting period using:			
	Level 1	Level 2	Level 3	Total
2017[1]				
Non-derivative financial assets				
Held for trading:				
Loans and advances to customers	-	3.2	-	3.2
Designated at fair value:				
Loans and advances to customers	-	171.2	3.8	175.0
Available-for-sale financial assets:				
Investment securities	1,462.3	1.9	823.5	2,287.7
Equity shares	0.3	2.3	24.0	26.6
Derivative financial assets	-	232.4	-	232.4
Non-financial assets				
Investment properties	-	-	2.3	2.3
Total assets carried at fair value	1,462.6	411.0	853.6	2,727.2
Derivative financial liabilities	-	315.0	-	315.0
Total liabilities carried at fair value	-	315.0	-	315.0

1. In accordance with the transitional provisions in IFRS 9, comparative figures have not been restated. See note 36 to the consolidated financial statements for details of changes in accounting policy.

Key considerations in the calculation of fair values for financial assets and liabilities measured at fair value are as follows:

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

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

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

- **Loans and advances to customers**
  Loans and advances to customers primarily comprise of corporate loans of £131.7m as at 31 December 2018 (2017: £158.1m) which are fair valued through profit or loss using observable inputs. Loans held at fair value are valued at the sum of all future expected cash flows, discounted using a yield curve based on observable market inputs.

- **Derivative financial instruments**
  Over-the-counter (i.e. non-exchange traded) derivatives are valued using valuation models which are based on observable market data. Valuation models calculate the present value of expected future cash flows, based upon 'no arbitrage' principles. The Group and Bank enter 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.

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

- **Investment securities**
  Investment securities comprise of RMBS of £399.3m (FVOCI) and £3.5m (FVTPL – mandatorily measured) as at 31 December 2018 (2017 AFS: £823.5m). An independent third party valuation agent is used to provide prices for the rated RMBS obtained from large financial institutions. These prices are indicative values only and do not represent an offer to purchase the securities. These RMBS represent the Group's and Bank's interests in unconsolidated structured entities.

  A 1% increase or decrease in the price of the notes will result in the value increasing or decreasing by approximately £4.0m respectively.

- **Equity shares**
  Equity shares comprise of US Dollar denominated convertible preference shares in Visa International, which are classified as FVTPL – designated, with any movements in fair value being recognised through profit or loss. The fair value of the Visa International shares has been calculated by taking the period end NYSE share price and discounting for illiquidity and clawback.

  If the illiquidity premium to the discount rate was assumed to be double, it would result in a reduction in the overall fair value of the equity shares of £7.2m (27.7%) as at 31 December 2018.

- **Other assets**
  Other assets comprise of the Surrendered Loss Debtor of £32.9m as at 31 December 2018. This financial instrument was reclassified from 'amortised cost' under IAS 39 to 'FVTPL – mandatorily measured' under IFRS 9 (see note 36 to the consolidated financial statements for further details). The 31 December 2017 amortised cost carrying value under IAS 39 was £71.6m with disclosure fair value of £69.6m. The fair value was determined by discounting the expected cash flows under the terms of the agreement with Co-operative Group. Cash flows are discounted at a discount rate reflecting the yield of the longest maturity Co-operative Group bond in issue (adjusted to reflect the weighted average maturity of cash flows due from Co-operative Group), plus a premium to estimate the uncertainties associated with the matters set out in note 2.2.5 to the consolidated financial statements. The premium is calculated applying risk parameter estimation theory using observable inputs from related (but not identical) financial instruments or indices.

- **Investment properties**
  Investment properties within level 3 are valued by using recent valuations of individual assets within the portfolio, 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:

	Group and Bank							
	Fair value at the end of the previous year	**IFRS 9 opening balance adjustments[1]**	**Fair value at the beginning of the year**	**Purchases and transfers in**	**Sales, transfers out and repayments**	**Other comprehen-sive income**	**Income statement**	**Fair value at the end of the year**
2018								
Loans and advances to customers	3.8	2.6	6.4	-	(1.3)	-	-	**5.1**
Investment securities	823.5	-	823.5	-	(410.1)	(11.6)	1.0	**402.8**
Equity shares	24.0	-	24.0	-	-	-	2.0	**26.0**
Investment properties	2.3	-	2.3	-	(0.1)	-	0.1	**2.3**
Other assets	-	55.7	55.7	-	5.3	-	(28.1)	**32.9**
	853.6	**58.3**	**911.9**	**-**	**(406.2)**	**(11.6)**	**(25.0)**	**469.1**
2017								
Loans and advances to customers	4.9	-	4.9	-	(0.9)	-	(0.2)	3.8
Investment securities	1,307.4	-	1,307.4	4.2	(500.8)	5.0	7.7	823.5
Equity shares	19.3	-	19.3	-	-	4.7	-	24.0
Investment properties	2.2	-	2.2	-	-	-	0.1	2.3
Other assets	-	-	-	-	-	-	-	-
	1,333.8	-	1,333.8	4.2	(501.7)	9.7	7.6	853.6

1. Loans and advances to customers adjustment all relates to reclassification from 'Loans and receivables' under IAS 39 to 'FVTPL – mandatorily measured' under IFRS 9. Other assets adjustment of £55.7m is comprised of £71.6m reclassification from 'Loans and receivables' under IAS 39 to 'FVTPL – mandatorily measured' under IFRS 9 and £(15.9m) remeasurement. See note 36 to the consolidated financial statements for details of changes in accounting policy.

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

The carrying values of financial assets and liabilities measured at amortised cost are determined in compliance with the accounting policies in note 1 to the consolidated financial statements and their fair values are analysed in the following tables by the three level fair value hierarchy set out above. There were no transfers between level 1 and 2 during the year.

	Group					
		Fair value				
	Total carrying value	**Level 1**	**Level 2**	**Level 3**	**Items where fair value approximates carrying value**	**Total**
2018						
Financial assets						
Cash and balances at central banks	**1,843.8**	-	-	-	1,843.8	**1,843.8**
Loans and advances to banks	**485.8**	-	-	-	485.8	**485.8**
Loans and advances to customers	**17,583.1**	-	-	16,112.3	1,291.2	**17,403.5**
Investment securities	**89.1**	-	-	87.3	-	**87.3**
Other assets	**21.8**	-	-	-	21.8	**21.8**
Financial liabilities						
Deposits by banks	**1,433.5**	-	1,436.4	-	2.5	**1,438.9**
Customer accounts	**18,735.8**	-	-	4,163.0	14,582.1	**18,745.1**
Debt securities in issue	**617.6**	640.8	-	-	-	**640.8**
Other liabilities	**92.1**	-	-	-	92.1	**92.1**

	Group					
		Fair value				
	Total carrying value	Level 1	Level 2	Level 3	Items where fair value approximates carrying value	Total
2017						
Financial assets						
Cash and balances at central banks	4,032.1	-	-	-	4,032.1	4,032.1
Loans and advances to banks	574.8	-	9.3	-	565.0	574.3
Loans and advances to customers	16,566.3	-	-	14,721.3	1,604.0	16,325.3
Investment securities	100.0	-	-	98.8	-	98.8
Other assets	95.3	-	-	69.6	23.7	93.3
Financial liabilities						
Deposits by banks	1,122.7	-	1,115.9	-	3.4	1,119.3
Customer accounts	20,635.0	-	-	5,452.1	15,203.2	20,655.3
Debt securities in issue	627.4	658.2	-	-	-	658.2
Other liabilities	34.7	-	-	-	34.7	34.7

	Bank					
		Fair value				
	Total carrying value	**Level 1**	**Level 2**	**Level 3**	**Items where fair value approximates carrying value**	**Total**
2018						
Financial assets						
Cash and balances at central banks	**1,843.8**	-	-	-	1,843.8	**1,843.8**
Loans and advances to banks	**485.8**	-	-	-	485.8	**485.8**
Loans and advances to customers	**17,583.1**	-	-	16,112.3	1,291.2	**17,403.5**
Investment securities	**89.1**	-	-	87.3	-	**87.3**
Other assets	**21.8**	-	-	-	21.8	**21.8**
Financial liabilities						
Deposits by banks	**1,433.5**	-	1,436.4	-	2.5	**1,438.9**
Customer accounts	**18,735.9**	-	-	4,163.0	14,582.2	**18,745.2**
Debt securities in issue	**617.6**	640.8	-	-	-	**640.8**
Other liabilities	**92.1**	-	-	-	92.1	**92.1**

	Bank					
		Fair value				
	Total carrying value	Level 1	Level 2	Level 3	Items where fair value approximates carrying value	Total
2017						
Financial assets						
Cash and balances at central banks	4,032.1	-	-	-	4,032.1	4,032.1
Loans and advances to banks	574.8	-	9.3	-	565.0	574.3
Loans and advances to customers	16,566.3	-	-	14,721.3	1,604.0	16,325.3
Investment securities	100.0	-	-	98.8	-	98.8
Other assets	95.3	-	-	69.6	23.7	93.3
Financial liabilities						
Deposits by banks	1,122.7	-	1,115.9	-	3.4	1,119.3
Customer accounts	20,635.1	-	-	5,452.1	15,203.4	20,655.5
Debt securities in issue	627.4	658.2	-	-	-	658.2
Other liabilities	34.7	-	-	-	34.7	34.7

Key considerations in the calculation of fair values of financial instruments measured at amortised cost are as follows:

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

  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. The amortised cost value of all other loans and advances to banks and deposits by banks are deemed to be a close approximation of their fair value due to their short maturity.

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

- **Loans and advances to customers**
  The fair value of loans and advances to customers in total is 99.0% of the carrying value as at 31 December 2018 (2017: 98.5%). The increase in 2018 is due to a combination of the growth of higher-valued Retail mortgages and reduction of the lower-valued Optimum mortgages and Corporate loans.

  The overall fair value is less than par primarily due to two main factors:
  - customer interest rates are below the market rate for the period until expected maturity or the repricing date, if earlier; and
  - credit risk adjustments due to incurred and expected future credit losses.

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

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

  Other reporting entities may use different valuation methodologies and assumptions in determining fair values for which no observable market prices are available.

- **Investment securities**
  Investment securities comprise of:
  - RMBS measured at amortised cost of £77.1m as at 31 December 2018 (2017: £87.0m), being a 5% regulatory holding of the rated notes of the Warwick Finance Three unconsolidated structured entity. The remaining 95% is privately held therefore there are no available market prices. An in-house model is used that sources independent market data for disclosure purposes only.
  - Securities measured at amortised cost of £12.0m as at 31 December 2018 (2017: £13.0m) as the quoted price is in an inactive market.

- **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.

d) Fair value of transferred assets and associated liabilities
Securitisation vehicles
When the sale of the loans and advances to customers to certain securitisation vehicles fails to meet the derecognition criteria, then these loans remain on the balance sheet. Therefore a deemed loan financial liability is recognised on the 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, and when the securitisations unwind.

The securitisation vehicles have issued floating rate notes which are secured on the loans and advances to customers. Prior to the call dates, the notes are redeemable in part, such redemptions being limited to the net capital received from mortgagors in respect of the underlying assets.

Substantially all of the risks and rewards of ownership are retained. The Group benefits to the extent to which surplus income generated by the transferred mortgage portfolios exceeds the administration costs of those mortgages, whilst continuing to bear the credit risk of these mortgage assets, on account of holding subordinated notes issued by the securitisation vehicles.

In 2017, £1.4bn of mortgages was sold beneficially to Silk Road Finance Number Four plc. The issued notes from the securitisation were all retained and therefore are not shown in the consolidated balance sheet.

Covered bond Limited Liability Partnerships
Moorland Covered Bonds LLP was established as a result of a £1.4bn covered bond retained issuance. Loans and advances to customers of £1.9bn were transferred to Moorland Covered Bonds LLP. The transfer was funded by a loan of £1.4bn and capital contribution of £0.5bn. During October 2011 the £1.4bn loan was repaid. Following additional capital contribution repayment and on achieving Regulated Covered Bond status there was a public issuance of notes in November 2011 totalling £0.6bn. At the year end the Group held a loan of £0.6bn (2017: £0.6bn) and a capital contribution of £0.6bn (2017: £0.6bn) with Moorland Covered Bonds LLP.

Moorland Covered Bonds LLP does not have ordinary share capital. The Group’s interest in Moorland Covered Bonds LLP is in substance no different from a wholly owned subsidiary and consequently it is fully consolidated. The table below shows the carrying values and fair values of the assets transferred to the covered bond and their associated liabilities:

	Group and Bank				
	Carrying amount of transferred loans and advances to customers	**Carrying amount of fixed and floating rate notes**	**Fair value of transferred loans and advances to customers**	**Fair value of fixed and floating rate notes**	**Net fair value position**
2018					
Moorland Covered Bonds LLP	1,173.6	598.5	1,176.0	655.6	**520.4**
2017					
Moorland Covered Bonds LLP	1,184.2	597.9	1,173.8	654.9	518.9

Assets pledged
Assets are pledged as collateral under repurchase agreements with other banks. These deposits are not available to finance the Group’s day-to-day operations.

	Group and Bank				
	Carrying amount of assets not derecognised	**Carrying amount of associated liabilities**	**Fair value of assets not derecognised**	**Fair value of associated liabilities**	**Net fair value position**
2018					
Investments securities sold under repurchase agreements	470.7	468.8	470.7	468.8	**1.9**
2017					
Investments securities sold under repurchase agreements	1,206.3	920.4	1,206.3	920.4	285.9

Associated liabilities are included within deposits by banks.

Assets sold under repurchase agreements include mortgage backed securities (£135.0m of assets and associated liabilities of £135.4m) and UK government gilts and a European Investment Bank (EIB) bond (£335.7m of assets and associated liabilities of £333.4m).

34. Interests in unconsolidated structured entities

The table below represent the continuing involvement in securitisations where assets are transferred to an unconsolidated SPE, but some of the notes issued by the SPE are retained. These are notes issued by Warwick Finance One, Two and Three and a residual interest in Warwick Finance Three. These notes are reported as investment securities. Warwick Finance One and Two are classified as Fair Value through Other Comprehensive Income, Warwick Finance Three has been classified as amortised cost, and the residual interest in Warwick Finance Three has been classified as fair value through profit or loss. The maximum exposure to loss is the carrying value of these instruments.

	Group and Bank				
	Carrying amount of continuing involvement in statement of financial position		**Fair value of continuing involvement**		**Maximum exposure to loss**
	Assets	**Liabilities**	**Assets**	**Liabilities**	
31 December 2018	**480.0**	**-**	**478.8**	**-**	**480.0**

	Group and Bank				
	Carrying amount of continuing involvement in statement of financial position		Fair value of continuing involvement		Maximum exposure to loss
	Assets	Liabilities	Assets	Liabilities	
31 December 2017	910.5	-	910.2	-	910.5

	Group and Bank				
	Gain or loss recognised at transfer date	**Gain or loss recognised on sale**	**Interest income/ (expense) recognised in the year**	**FV movement recognised in OCI**	**Income/ (expense) recognised cumulatively**
31 December 2018	**-**	**2.6**	**14.4**	**(11.6)**	**17.0**

	Group and Bank				
	Gain or loss recognised at transfer date	Gain or loss recognised on sale	Interest income/ (expense) Recognized in the year	FV movement recognised in OCI	Income/ (expense) recognised cumulatively
31 December 2017	-	4.8	17.9	5.0	22.7

35. Events after the balance sheet date

Group reconstruction in readiness for MREL debt issue

On 11 February 2019 a group reconstruction was completed in readiness for issuing MREL in 2019 and beyond. The objective of the group reconstruction was to achieve structural subordination in order that any debt issued from a new intermediary holding company will meet MREL criteria. The group reconstruction was transacted as follows:

- On 1 October 2018, Balloon Street Issuerco Limited was incorporated as a wholly owned subsidiary of Holding Company with a share capital comprising one fully paid up £0.0001 share issued at par.
- On 21 January 2019 Balloon Street Issuerco Limited issued 9,029,130,200 shares of nominal value of £0.0001 each to the Holding Company in exchange for 100% of the Bank Company issued share capital of 511,456,510 shares of £0.05 each, the consideration being equal to the carrying value of the Bank Company in Holding Company's balance sheet.
- On 7 February 2019 Balloon Street Issuerco Limited changed its name to The Co-operative Bank Finance Limited.

Consequently The Co-operative Bank Finance Limited became the immediate parent of the Bank Company from 11 February 2019, with the Holding Company remaining the ultimate parent of the Bank Company.

As the Bank Company shares were issued for a consideration equal to the carrying value of the Bank Company in Holding Company's balance sheet, no profit or loss was recorded on the sale of Bank Company to Issuer Company. There was no impact on the consolidated position of Group or Bank as a result of this group reconstruction.

36. IFRS 9 transitional disclosures

The impact of transition to IFRS 9 on 1 January 2018 was a net decrease in total shareholders' equity of £17.1m (net of tax). This comprises a net decrease in shareholders' equity of £1.2m arising from the application of the new impairment requirements of IFRS 9 (including £0.2m relating to the impairment impact on a joint venture) and a decrease in shareholders' equity of £15.9m arising from the application of the new classification and measurement requirements of IFRS 9. The reclassifications and remeasurements set out in the Bank's transitional disclosures below were also applied to the Bank Company. The following tables set out the impact on transition on 1 January 2018 in more detail:

a) Summary impact on opening equity

		Group									
Total equity	**Ref[1]**	**Ordinary share capital**	**Share premium account**	**AFS reserve**	**FVOCI reserve**	**Capital redemption reserve**	**Cash flow hedge reserve**	**Capital re-organisation reserve**	**Defined benefit pension scheme**	**Retained earnings**	**Total Equity**
IAS 39 31 December 2017		0.9	313.8	25.1	-	410.0	29.9	1,737.5	70.8	(1,082.4)	1,505.6
Equity shares AFS to FVTPL	vi	-	-	(8.3)	-	-	-	-	-	8.3	-
Deferred tax on equity shares reclassification	vi	-	-	2.1	-	-	-	-	-	(2.1)	-
Warwick 3 residual interest AFS to FVTPL	v	-	-	(0.5)	-	-	-	-	-	0.5	-
Other treasury AFS to FVOCI		-	-	(18.4)	18.4	-	-	-	-	-	-
Surrendered Loss Debtor amortised cost to FVTPL	viii	-	-	-	-	-	-	-	-	(15.9)	(15.9)
Impairment	i/vii	-	-	-	-	-	-	-	-	(1.0)	(1.0)
Impact of IFRS 9 on joint ventures	e)	-	-	-	-	-	-	-	-	(0.2)	(0.2)
Total IFRS 9 opening balance adjustments		-	-	(25.1)	18.4	-	-	-	-	(10.4)	(17.1)
IFRS 9 1 January 2018		0.9	313.8	-	18.4	410.0	29.9	1,737.5	70.8	(1,092.8)	1,488.5

1. See section c) for reference and further explanation. Also, see section e) for further detail on joint ventures.

		Bank									
Total equity	**Ref[1]**	**Ordinary share capital**	**Share premium account**	**AFS reserve**	**FVOCI reserve**	**Capital redemption reserve**	**Cash flow hedge reserve**	**Capital re-organisation reserve**	**Defined benefit pension scheme**	**Retained earnings**	**Total Equity**
IAS 39 31 December 2017		25.6	2,416.9	25.1	-	410.0	29.9	-	70.8	(1,472.8)	1,505.5
Equity shares AFS to FVTPL	vi	-	-	(8.3)	-	-	-	-	-	8.3	-
Deferred tax on equity shares reclassification	vi	-	-	2.1	-	-	-	-	-	(2.1)	-
Warwick 3 residual interest AFS to FVTPL	v	-	-	(0.5)	-	-	-	-	-	0.5	-
Other treasury AFS to FVOCI		-	-	(18.4)	18.4	-	-	-	-	-	-
Surrendered Loss Debtor amortised cost to FVTPL	viii	-	-	-	-	-	-	-	-	(15.9)	(15.9)
Impairment	i/vii	-	-	-	-	-	-	-	-	(1.0)	(1.0)
Impact of IFRS 9 on joint ventures	e)		-	-	-	-	-	-	-	(0.2)	(0.2)
Total IFRS 9 opening balance adjustments		-	-	(25.1)	18.4	-	-	-	-	(10.4)	(17.1)
IFRS 9 1 January 2018		25.6	2,416.9	-	18.4	410.0	29.9	-	70.8	(1,483.2)	1,488.4

1. See section c) for reference and further explanation. Also, see section e) for further detail on joint ventures.

b) Classification and measurement of financial instruments

The measurement category and the carrying amount of financial instruments in accordance with IAS 39 and IFRS 9 at 1 January 2018 are compared as follows:

		Group and Bank			
		IAS 39		IFRS 9	
Financial assets	**Ref[1]**	**Measurement category**	**Carrying amount**	**Measurement category**	**Carrying amount**
Cash and balances at central banks		Amortised cost - loans and receivables	4,032.1	Amortised cost	4,032.1
Loans and advances to banks		Amortised cost - loans and receivables	574.8	Amortised cost	574.8
Loans and advances to customers	i, ii	Amortised cost - loans and receivables	16,566.3	Amortised cost	16,562.8
	ii	FVTPL – designated	175.0	FVTPL – designated	178.2
	ii	FVTPL – held for trading	3.2	FVTPL – held for trading	-
	iii	N/A	-	FVTPL – mandatory	2.6
Investment securities	iv	Amortised cost – loans and receivables	100.0	Amortised cost	100.0
	iv	Available-for-sale	2,287.7	FVOCI	2,283.2
		FVTPL – designated	-	FVTPL – designated	-
	v	N/A	-	FVTPL – mandatory	4.5
Derivative financial instruments		FVTPL – held for trading	154.9	FVTPL – mandatory	154.9
		FVTPL – In a hedge relationship[1]	77.5	FVTPL – In a hedge relationship[2]	77.5
Equity shares	vi	Available-for-sale	26.6	FVPL (FVOCI election not applied)	26.6
Other assets	vii	Amortised cost – loans and receivables	95.3	Amortised cost	23.6
	viii	N/A	-	FVTPL - mandatory	69.6

1. See section c) for reference and further explanation.
2. For derivative financial instruments designated within a cash flow hedge relationship, to the extent that the hedge is effective, changes in fair value are taken to the cash flow hedging reserve through other comprehensive income. Any hedge ineffectiveness is recognised in profit or loss.

There were no changes to the classification and measurement of financial liabilities. Own debt is not currently measured at fair value.

c) Reconciliation of balance sheet positions from IAS 39 to IFRS 9

The following table sets out a reconciliation of the carrying amounts of financial instruments from their previous measurement category under IAS 39 to their new IFRS 9 category on transition to IFRS 9 on 1 January 2018:

		Group and Bank			
Amortised cost	**Ref**	**IAS 39 carrying amount 31 December 2017**	**Reclassifications**	**Remeasurements**	**IFRS 9 carrying amount 1 January 2018**
Cash and balances at central banks					
Closing balance under IAS 39 and opening balance under IFRS 9		4,032.1			4,032.1
Loans and advances to banks					
Closing balance under IAS 39 and opening balance under IFRS 9		574.8			574.8
Loans and advances to customers					
Closing balance under IAS 39		16,566.3			
Reclassification to FVTPL	iii		(2.6)	-	
Remeasurement of credit impairment loss allowance	i		-	(0.9)	
Opening balance under IFRS 9					16,562.8
Investment securities					
Closing balance under IAS 39 and opening balance under IFRS 9		100.0			100.0
Other assets					
Closing balance under IAS 39		95.3			
Reclassification to FVTPL	viii		(71.6)	-	
Remeasurement of credit impairment loss allowance	vii		-	(0.1)	
Opening balance under IFRS 9					23.6
Total financial assets measured at amortised cost		**21,368.5**	**(74.2)**	**(1.0)**	**21,293.3**

Fair value through other comprehensive income (debt instruments)	Ref	Group and Bank IAS 39 carrying amount 31 December 2017	Reclassifications	Remeasurements	IFRS 9 carrying amount 1 January 2018
Investment securities					
Closing balance under IAS 39		N/A			
Reclassification from available-for-sale			2,283.2		
Opening balance under IFRS 9					2,283.2
Total financial assets measured at FVTOCI		**N/A**	**2,283.2**	**-**	**2,283.2**

Fair value through profit or loss	Ref	Group and Bank IAS 39 carrying amount 31 December 2017	Reclassifications	Remeasurements	IFRS 9 carrying amount 1 January 2018
Loans and advances to customers - held for trading					
Closing balance under IAS 39		3.2			
Reclassification to designated at FVTPL	ii		(3.2)	-	
Opening balance under IFRS 9					-
Loans and advances to customers – designated					
Closing balance under IAS 39		175.0			
Reclassification from held for trading	ii		3.2	-	
Opening balance under IFRS 9					178.2
Loans and advances to customers – mandatory					
Closing balance under IAS 39		N/A			
Reclassification from amortised cost	iii		2.6	-	
Opening balance under IFRS 9					2.6
Investment securities – mandatory					
Closing balance under IAS 39		N/A			
Reclassification from held for trading	v		4.5	-	
Opening balance under IFRS 9					4.5
Derivative financial instruments					
Closing balance under IAS 39 and opening balance under IFRS 9		232.4			232.4
Other assets - mandatory					
Closing balance under IAS 39		N/A			
Reclassification from amortised cost	viii		71.6	-	
Remeasurement following reclassification from amortised cost to FVTPL	viii		-	(15.9)	
Opening balance under IFRS 9					55.7
Equity shares					
Closing balance under IAS 39		-	-	-	
Reclassification from available-for-sale	vi		26.6	-	
Opening balance under IFRS 9					26.6
Total financial assets measured at FVTPL		**410.6**	**105.3**	**(15.9)**	**500.0**

Available-for-sale	Ref	IAS 39 carrying amount 31 December 2017	Reclassifications	Remeasurements	IFRS 9 carrying amount 1 January 2018
		Group and Bank			
Investment securities					
Closing balance under IAS 39		2,287.7			
Reclassification to fair value through other comprehensive income			(2,283.2)	-	
Reclassification to fair value through profit and loss	v		(4.5)	-	
Opening balance under IFRS 9					-
Equity shares					
Closing balance under IAS 39		26.6			
Reclassification to FVTPL	vi		(26.6)	-	
Opening balance under IFRS 9					-
Total financial assets measured at AFS		**2,314.3**	**(2,314.3)**	**-**	**-**

There were no reclassifications of financial liabilities on transition to IFRS 9.

A total re-measurement loss of £17.1m was recognised in opening reserves at 1 January 2018, reflecting £16.9m as shown in the financial instrument tables above plus £0.2m related to joint ventures as set out in e) below.

The following table sets out how applying the new classification and measurement requirements of IFRS 9 led to changes in the classification of certain financial assets held by the Group and Bank as shown in the table above.

Ref	Explanation of change
i	**Remeasurement of credit impairment loss allowance of loans and advances to customers** Remeasurement of credit impairment losses on an IFRS 9 expected credit loss basis has resulted in an increase in provisions of £0.9m with a resulting decrease in the carrying value of loans and advances to customers of £0.9m.
ii	**Reclassification of loans and advances to customers from HFT (FVTPL) to designated at FVTPL** Certain loans held-for-trading were identified for reclassification to designated at FVTPL during transition to IFRS 9. No other changes in designation of FVTPL assets were applied on transition on 1 January 2018.
iii	**Reclassification of loans and advances to customers from amortised cost to mandatorily at FVTPL** Detailed analysis of the contractual cash flows of loans and advances to customers resulted in the identification of a small pool of mortgages which failed the solely payment of principal and interest test and were therefore reclassified to FVTPL on 1 January 2018.
iv	**Remeasurement of credit impairment loss allowance of investment securities at amortised cost and FVOCI** Following detailed credit risk analysis, a £nil credit loss provision has been recognised on transition to IFRS 9 in respect of investment securities at amortised cost and FVOCI.
v	**Reclassification of investment securities from amortised cost to mandatorily at FVTPL** Detailed analysis of the contractual cash flows of investment securities resulted in the identification of financial instruments with leveraged credit risk which failed the solely payment of principal and interest test and were therefore reclassified to FVTPL on 1 January 2018.
vi	**Investments in equity shares** The Group did not elect to classify any equity instruments at FVOCI on transition to IFRS 9 and therefore these are required to be classified at fair value through profit or loss. The same applies to the associated deferred tax asset.
vii	**Remeasurement of credit impairment loss allowance of other assets** Remeasurement of credit impairment losses on an IFRS 9 expected credit loss basis has resulted in an increase in provisions of £0.1m with a resulting decrease in the carrying value of other assets of £0.1m.
viii	**Reclassification of the Surrendered Loss Debtor from amortised cost to mandatorily at FVTPL** Detailed analysis of the contractual cash flows of the Surrendered Loss Debtor resulted in the identification of contractual features of the financial instrument which failed the solely payment of principal and interest test. The financial instrument was therefore reclassified to FVTPL on 1 January 2018 resulting in a loss on remeasurement of £15.9m.

d) Reconciliation of impairment allowance balances from IAS 39 to IFRS 9

A reconciliation of the impairment allowances by category in accordance with IAS 39 and the provisions in accordance with IAS 37 as at 31 December 2017 to the IFRS 9 loss allowance at 1 January 2018 is shown in the table below:

	Group and Bank			
Measurement category	Loan loss allowance under IAS 39/provision under IAS 37	Reclassifications	Remeasurements	Loss allowance under IFRS 9
Loans and receivables (IAS 39)/Financial assets at amortised cost (IFRS 9)				
Cash and balances at central banks	-	-	-	-
Loans and advances to banks	-	-	-	-
Loans and advances to customers	80.0	-	0.9	80.9
Investment securities	-	-	-	-
Other assets	-	-	0.1	0.1
	80.0	-	1.0	81.0
Available-for-sale (IAS 39)/Fair value through other comprehensive income (IFRS 9)				
Investment securities	-	-	-	-
Commitments and financial guarantee contracts[1]				
Provisions (financial guarantees)	-	-	-	-
Total	80.0	-	1.0	81.0

1. The allowance attributable to undrawn loan commitments is included within the expected credit loss for financial assets at amortised cost above. The provision for financial guarantee contracts recorded as an IAS 37 provision was £0.046m.

Further information on the measurement of the impairment allowance under IFRS 9 can be found in the risk management section.

Reconciliation from IAS 39 to IFRS 9 – impairment allowance for loans and advances to customers

The table below presents a reconciliation of the 31 December 2017 IAS 39 impairment allowance (under an incurred loss approach) to the IFRS 9 impairment allowance (under an expected credit loss approach):

	Group and Bank
	Impairment allowance
Total impairment allowance as at 31 December 2017 under IAS 39	**80.0**
Incremental impact of 12 month impairment allowance	(5.8)
Incremental impact of lifetime impairment allowance	6.7
Total impact of IFRS 9 impairment allowances	**0.9**
Total impairment allowance as at 1 January 2018 under IFRS 9	**80.9**

The impact of including an allowance generated by multiple economic scenario modelling is reflected within the individual categories above.

The IAS 39 and IFRS 9 impairment allowance methodologies are very different and therefore assumptions have been applied to derive the incremental impact under the categories in the table above for illustration purposes.

Incremental impact of 12 month impairment allowance

This category comprises stage 1 balances which have not had a significant increase in credit risk under IFRS 9, against exposures that may have been subject to an impairment allowance under IAS 39. This category includes allowances for unidentified impairment for accounts that do not trigger criteria for transition to stage 2. The net decrease is mainly attributed to differences in the way that PD is calculated under IFRS 9 and the application of IFRS 9 methodology to post model adjustments.

Incremental impact of lifetime impairment allowance

This category comprises:

- Stage 2 balances which have had a significant increase in credit risk under IFRS 9, against exposures that may have been subject to an impairment allowance under IAS 39; and
- Stage 3 balances which are impaired under IFRS 9, against exposures in default which were subject to impairment allowance under IAS 39.

The net increase is mainly attributed to differences in the way that PD is calculated under IFRS 9, the application of a new definition of default to Retail Secured and Optimum and the application of IFRS 9 methodology to post model adjustments.

e) Reconciliation of investments in joint ventures as a result of transition from IAS 39 to IFRS 9

	Group and Bank		
	31 December 2017	Impact of adoption of IFRS 9 on JV opening reserves	1 January 2018
Investments in joint ventures	6.3	(0.2)	6.1

The Bank Company balance sheet
At 31 December 2018
£millions

	Note	2018	2017[1]
Assets			
Cash and balances at central banks	3	**1,843.8**	4,032.0
Loans and advances to banks	4	**380.4**	460.3
Loans and advances to customers	5	**17,614.3**	16,608.2
Fair value adjustments for hedged risk		**53.4**	70.3
Investment securities	6	**2,744.5**	3,737.7
Derivative financial instruments	7	**165.4**	197.4
Property, plant and equipment classified as held-for-sale		**3.9**	2.8
Equity shares	8	**26.4**	24.3
Investments in subsidiaries/group undertakings	21	**49.4**	51.6
Investment properties		**2.3**	2.3
Other assets	9	**39.9**	79.3
Prepayments and accrued income	10	**31.8**	24.6
Current tax assets		**-**	2.5
Property, plant and equipment	11	**40.8**	44.4
Intangible assets	12	**72.4**	81.5
Amounts owed by other Co-operative Bank undertakings	22	**1,306.4**	1,322.2
Deferred tax assets	18	**-**	0.6
Net retirement benefit asset	19	**623.5**	157.7
Total assets		**24,998.6**	26,899.7

	Note	2018	2017[1]
Liabilities			
Deposits by banks	13	**1,433.5**	1,122.7
Customer accounts		**18,736.4**	20,635.7
Debt securities in issue	14	**601.5**	600.7
Derivative financial instruments	7	**256.7**	308.8
Amounts owed to other Co-operative Bank undertakings		**1,979.1**	2,505.7
Other liabilities	15	**85.3**	33.9
Accruals and deferred income	16	**49.8**	59.9
Provisions	17	**103.0**	157.4
Deferred tax liabilities	18	**38.7**	-
Net retirement benefit liability	19	**7.6**	11.3
Total liabilities		**23,291.6**	25,436.1

	Note	2018	2017[1]
Capital and reserves attributable to the Bank Company's equity holders			
Ordinary share capital	23	**25.6**	25.6
Share premium account	23	**2,416.9**	2,416.9
Retained earnings		**(1,594.9)**	(1,514.4)
Available-for-sale reserve		**-**	24.8
Fair value through other comprehensive income reserve		**13.9**	-
Capital redemption reserve		**410.0**	410.0
Cash flow hedging reserve		**20.0**	29.9
Defined benefit pension reserve		**415.5**	70.8
Total equity		**1,707.0**	1,463.6
Total liabilities and equity		**24,998.6**	26,899.7

1. In accordance with the transitional provisions in IFRS 9, comparative figures have not been restated. See note 36 to the consolidated financial statements for details of changes in accounting policy.

Net loss attributable to equity shareholders was £73.8m (2017: profit £32.8m).

The notes on pages 188 to 209 form part of these financial statements.

Approved by the Board of The Co-operative Bank plc on 27 February 2019:

Robert Dench	Andrew Bester
Chairman	Chief Executive Officer

The Bank Company statement of cash flows
For the year ended 31 December 2018
£millions

	Note	2018	2017[1]
Cash flows (used in)/from operating activities:			
(Loss)/profit before taxation		**(142.8)**	41.2
Adjustments for non-cash movements:			
Gain on capital raise		**-**	(7.4)
Non-cash movements on pension		**4.4**	(51.9)
Interest payable in respect of other borrowed funds		**-**	25.4
Credit impairment (gains)/losses		**(5.4)**	1.3
Depreciation, amortisation and impairment of property, plant and equipment and intangibles		**33.5**	39.0
Other non-cash movements including exchange rate movements		**105.6**	23.3
Net impairment of investment in subsidiaries		**2.2**	167.3
Unwind of fair value adjustments arising on transfer of engagements		**-**	1.7
Changes in operating assets and liabilities:			
Increase in deposits by banks		**310.8**	102.7
(Increase)/decrease in prepayments and accrued income		**(7.2)**	4.1
Decrease in accruals and deferred income		**(10.1)**	(31.4)
Decrease in customer accounts		**(1,899.3)**	(1,934.6)
Increase/(decrease) in debt securities in issue and borrowed funds		**0.8**	(406.1)
(Increase)/decrease in loans and advances to banks		**(16.6)**	3.5
(Increase)/decrease in loans and advances to customers		**(1,015.5)**	2,654.3
Decrease/(increase) in amounts owed by Co-operative Bank undertakings		**15.8**	(215.9)
(Decrease)/increase in amounts owed to Co-operative Bank undertakings		**(526.6)**	364.7
Net movement of other assets and other liabilities		**(70.3)**	(163.5)
Income tax/group relief received		**-**	71.6
Net cash flows (used in)/from operating activities		**(3,220.7)**	689.3
Cash flows from investing activities:			
Purchase of tangible and intangible fixed assets		**(24.4)**	(43.1)
Purchase of investment securities		**(462.6)**	(1,859.9)
Proceeds from sale of property, plant and equipment		**0.5**	4.9
Proceeds from sale of equity shares		**-**	25.3
Proceeds from sale and maturity of investment securities		**1,415.9**	1,651.6
Proceeds from sale of joint venture		**0.7**	-
Net movement on investments in Co-operative Bank undertakings		**-**	587.9
Dividends received		**5.9**	-
Net cash flows from investing activities		**936.0**	366.7
Cash flows from financing activities:			
Interest paid on other borrowed funds		**-**	(29.3)
Net cash raised through Restructuring and Recapitalisation		**-**	180.4
Net cash flows from financing activities		**-**	151.1
Net (decrease)/increase in cash and cash equivalents		**(2,284.7)**	1,207.1
Cash and cash equivalents at the beginning of the year		**4,454.7**	3,247.6
Cash and cash equivalents at the end of the year		**2,170.0**	4,454.7
Cash and balances with central banks	3	**1,789.6**	3,994.4
Loans and advances to banks	4	**380.4**	460.3
		2,170.0	4,454.7

1. In accordance with the transitional provisions in IFRS 9, comparative figures have not been restated. See note 36 to the consolidated financial statements for details of changes in accounting policy.

Reconciliation of movements of liabilities to cash flows arising from financing activities

	Other borrowed funds
Balance at 1 January 2017	472.6
Changes from financing cash flows	
Interest paid on other borrowed funds	(29.3)
Total changes from financing cash flows	(29.3)
Other changes	
Debt restructuring as part of capital raise	(468.7)
Interest payable on other borrowed funds	25.4
Balance at 31 December 2017	-

The notes on pages 188 to 209 form part of these financial statements.

The Bank Company statement of changes in equity
For the year ended 31 December 2018
£millions

	Attributable to equity holders of the Bank Company								
2018	**Share capital**	**Share premium**	**Available-for-sale reserve**	**FVOCI reserve**	**Cash flow hedging reserve**	**Capital redemption reserve**	**Defined benefit pension reserve**	**Retained earnings**	**Total equity**
At the beginning of the year	25.6	2,416.9	24.8	-	29.9	410.0	70.8	(1,514.4)	**1,463.6**
IFRS 9 opening balance adjustments	-	-	(24.8)	18.4	-	-	-	(6.7)	**(13.1)**
At the beginning of the year adjusted for IFRS 9	**25.6**	**2,416.9**	**-**	**18.4**	**29.9**	**410.0**	**70.8**	**(1,521.1)**	**1,450.5**
Total comprehensive (expense)/income for the year	-	-	-	(4.5)	(9.9)	-	344.7	(73.8)	**256.5**
At the end of the year	**25.6**	**2,416.9**	**-**	**13.9**	**20.0**	**410.0**	**415.5**	**(1,594.9)**	**1,707.0**

	Attributable to equity holders of the Bank Company							
2017[1]	Share capital	Share premium	Available-for-sale reserve	Cash flow hedging reserve	Capital redemption reserve	Defined benefit pension reserve	Retained earnings	Total equity
At the beginning of the year	22.6	1,736.9	38.2	56.4	410.0	9.5	(1,547.2)	726.4
Total comprehensive (expense)/income for the year	-	-	(13.4)	(26.5)	-	61.3	32.8	54.2
Issuance of new share capital	3.0	680.0	-	-	-	-	-	683.0
At the end of the year	25.6	2,416.9	24.8	29.9	410.0	70.8	(1,514.4)	1,463.6

1. In accordance with the transitional provisions in IFRS 9, comparative figures have not been restated. See note 36 to the consolidated financial statements for details of changes in accounting policy.

The notes on pages 188 to 209 form part of these financial statements.

NOTES TO THE BANK COMPANY FINANCIAL STATEMENTS
For the year ended 31 December 2018

1. Basis of preparation
The Co-operative Bank plc was incorporated in the UK and is registered in England and Wales.

The Bank Company financial statements have been prepared under the historic cost convention and approved by the Directors in accordance with IFRS as issued by the International Accounting Standards Board (IASB), and as adopted by the European Union (EU).

On including its financial statements within the Group's Annual Report and Accounts, the Bank Company is taking advantage of the exemption in Section 408 of the Companies Act 2006 not to present its individual income statement and related notes.

Accounting policies outlined in note 1 to the consolidated financial statements also apply to the Bank Company.

2. Net (loss)/profit attributable to equity shareholders of the Bank Company
On including the Bank Company financial statements here together with the consolidated Bank financial statements, the Bank Company is taking advantage of the exemption in Section 408 of the Companies Act 2006 not to present its individual income statement and related notes that form a part of these financial statements.

	2018	2017
Net (loss)/profit attributable to equity shareholders of the Bank Company	**(73.8)**	32.8

3. Cash and balances at central banks

	2018	2017
Cash in hand	**14.2**	48.9
Items in transit	**(27.3)**	(35.9)
Balances with the Bank of England other than mandatory reserve deposits	**1,802.7**	3,981.4
Included in cash and cash equivalents	**1,789.6**	3,994.4
Mandatory reserve deposits with the Bank of England	**54.2**	37.6
	1,843.8	4,032.0

Mandatory reserve deposits are not available for use in the day-to-day operations, are non-interest bearing and are not included in cash and cash equivalents. Items in transit represent unpresented cheques awaiting clearance.

4. Loans and advances to banks

	2018	2017
Items in course of collection from other banks	**2.4**	12.8
Placements with other banks[1]	**378.0**	447.5
Included in cash and cash equivalents	**380.4**	460.3
Other loans and advances to banks	**-**	-
	380.4	460.3

1. Obligatory netting arrangements are in place for repos and reverse repos transactions. As a result, the amount reduced by netting is £100.0m (2017: £300.0m), with the opposing impact in Deposits by banks.

An expected credit loss of £nil was recorded as at 31 December 2018 (2017: £nil) in relation to loans and advances to banks.

5. Loans and advances to customers

a) Analysis of the balance sheet

	2018	2017[1]
Gross loans and advances	**17,666.0**	16,687.1
Less: allowance for losses	**(51.7)**	(78.9)
	17,614.3	16,608.2

1. In accordance with the transitional provisions in IFRS 9, comparative figures have not been restated. See note 36 to the consolidated financial statements for details of changes in accounting policy.

Loans and advances to customers include £144.7m (2017: £178.2m) of financial assets at fair value through profit or loss to eliminate or significantly reduce a measurement or recognition inconsistency. Of these, £63.5m (2017: £80.2m) are secured by real estate collateral.

Loans and advances to customers include £2.0bn (2017: £2.5bn) pledged under the Bank Company's securitisation and covered bond activities. The Bank Company remains exposed to substantially all of the risks and rewards of ownership of these assets. Secured on these mortgage assets are £0.6bn (2017: £0.6bn) of fixed and floating rate notes.

Further details are set out in note 25, Analysis of credit risk exposure.

b) Concentration of exposure

Exposure is predominantly within the UK. Further information on the concentration of exposure is included within the risk management disclosures.

c) Analysis of allowance for losses

	Retail		**Optimum**		**Corporate**		
2018 (IFRS 9)	**Individual**	**Collective**	**Individual**	**Collective**	**Individual**	**Collective**	**Total**
At the beginning of the year as reported under IAS 39	-	41.1	-	6.9	29.0	1.9	**78.9**
IFRS 9 opening balance adjustments	-	(2.0)	-	-	-	2.9	**0.9**
At the beginning of the year adjusted for IFRS 9	**-**	**39.1**	**-**	**6.9**	**29.0**	**4.8**	79.8
Changes in assets which transitioned during the year[1]:							
To lifetime ECL	-	1.3	-	-	-	-	**1.3**
To credit impaired	-	4.6	-	0.2	0.1	-	**4.9**
To 12 month ECL	-	(0.8)	-	-	-	(0.2)	**(1.0)**
From credit impaired	-	(1.9)	-	(0.2)	(0.3)	-	**(2.4)**
Net changes in assets which transitioned during the year	**-**	**3.2**	**-**	**-**	**(0.2)**	**(0.2)**	2.8
Other charges/(releases):							
New assets originated or purchased	-	2.7	-	-	-	-	**2.7**
Other changes to risk parameters[2]	-	2.1	-	(1.5)	(5.7)	(2.0)	**(7.1)**
Net other charges/(releases)	**-**	**8.0**	**-**	**(1.5)**	**(5.9)**	**(2.2)**	(1.6)
Assets written off	-	(22.3)	-	(1.4)	(2.8)	-	**(26.5)**
At the end of the year	**-**	**24.8**	**-**	**4.0**	**20.3**	**2.6**	51.7

1. Includes the impact of both transition and repayments on assets which transitioned during the year.
2. Includes repayments (other than those related to assets which transitioned during the year) and changes due to other model inputs.

	Retail		Optimum		Corporate		
2017[1] (IAS 39)	Individual	Collective	Individual	Collective	Individual	Collective	Total
At the beginning of the year as reported	-	64.5	-	15.3	46.7	1.8	128.3
Charge/(release) against profits	-	10.6	-	(8.7)	(2.4)	0.1	(0.4)
Amounts written off	-	(30.8)	-	(2.9)	(15.2)	-	(48.9)
Unwind of discount allowance	-	-	-	-	(0.1)	-	(0.1)
Transfer between business units	-	(3.2)	-	3.2	-	-	-
At the end of the year	-	41.1	-	6.9	29.0	1.9	78.9

1. In accordance with the transitional provisions in IFRS 9, comparative figures have not been restated. See note 36 to the consolidated financial statements for details of the changes in accounting policy.

d) Finance lease receivables

	2018	2017
Gross investment in finance leases may be analysed as follows:		
No later than one year	**1.7**	1.8
Later than one year and no later than five years	**6.7**	6.8
Later than five years	**9.8**	11.4
	18.2	20.0
Unearned future finance income on finance leases	**(5.5)**	(6.2)
Net investment in finance leases	**12.7**	13.8

The net future finance leases may be analysed as follows:		
No later than one year	**1.0**	1.1
Later than one year and no later than five years	**4.5**	4.3
Later than five years	**7.2**	8.4
	12.7	13.8

The unguaranteed residual value of the finance leases is £nil (2017: £nil). Finance lease arrangements are with customers in a wide range of sectors including transport, retail and utilities.

6. Investment securities

a) Analysis of investment securities

	2018				2017[1]			
	Amortised cost	**FVOCI**	**FVTPL**	**Total**	Loans and Receivables	AFS[2]	FVTPL[3]	Total
Listed	**774.8**	**1,842.4**	**3.5**	**2,620.7**	1,312.4	2,287.7	-	3,600.1
Unlisted[4]	**123.8**	**-**	**-**	**123.8**	137.6	-	-	137.6
Gross and net investment securities	**898.6**	**1,842.4**	**3.5**	**2,744.5**	1,450.0	2,287.7	-	3,737.7

b) Movement in investment securities

	2018				2017[1]			
	Amortised cost	**FVOCI**	**FVTPL**	**Total**	Loans and Receivables	AFS[2]	FVTPL[3]	Total
At the beginning of the year	**1,450.0**	**2,283.2**	**4.5**	**3,737.7**	34.8	3,538.1	-	3,572.9
Acquisitions	**-**	**462.6**	**-**	**462.6**	1,538.6	321.3	-	1,859.9
Disposals and maturities	**(551.1)**	**(862.0)**	**-**	**(1,413.1)**	(124.5)	(1,520.8)	-	(1,645.3)
Exchange adjustments	**-**	**-**	**-**	**-**	(0.1)	-	-	(0.1)
Fair value movements through equity	**-**	**(5.0)**	**-**	**(5.0)**	-	(0.5)	-	(0.5)
Fair value through profit or loss	**-**	**(35.0)**	**(1.0)**	**(36.0)**	-	(48.5)	-	(48.5)
Amortisation	**-**	**1.1**	**-**	**1.1**	0.6	2.6	-	3.2
Movement in interest accrual	**(0.3)**	**(2.5)**	**-**	**(2.8)**	0.6	(6.2)	-	(5.6)
Write back of previously written off assets	**-**	**-**	**-**	**-**	-	1.7	-	1.7
At the end of the year	**898.6**	**1,842.4**	**3.5**	**2,744.5**	1,450.0	2,287.7	-	3,737.7

1. In accordance with the transitional provisions in IFRS 9, comparative figures have not been restated. See note 36 to the consolidated financial statements for details of changes in accounting policy.
2. The current year balances for investment securities AFS are £nil as this category does not exist following transition to IFRS 9.
3. The comparatives for FVTPL was £nil as all investment securities held as at 31 December 2017 were classified as AFS or amortised cost under IAS 39.
4. The comparatives were restated to reflect the listed status of the underlying instruments.

Included in investment securities are repurchase receivables of £329.4m. These receivables are gilts subject to repurchase transactions where the transferee has the ability to re-pledge or sell the assets. £165.1m of Warwick Finance Two securitisation notes have been pledged, with a 17% haircut, as security against the increased shortfall in the actuarial funding shortfall estimated by the Britannia Pension Scheme actuary on 5 April 2017. £276.9m AAA rated Silk Road 4 securitisation notes, with a 22% haircut, have been pledged against the Bank section of the Pace scheme as estimated by the Pace scheme actuary in April 2016. See note 28 to the consolidated financial statements for further details.

c) Analysis of investment securities by issuer

	2018	2017
Investment securities issued by public bodies:		
Government securities	**926.6**	1,113.0
Other public sector securities	**309.1**	223.8
Total investment securities issued by public bodies	**1,235.7**	1,336.8
Other debt securities:		
Other fixed and floating rate notes	**207.3**	127.4
Mortgage backed securities	**1,301.5**	2,273.5
Total investment securities issued by other issuers	**1,508.8**	2,400.9
Total investment securities	**2,744.5**	3,737.7

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

7. Derivative financial instruments

Various derivatives have been entered into to manage interest rate risk, some of which are held in a qualifying hedge accounting relationship (see the risk management section for more details on interest rate risk management strategies). Positive and negative fair values have not been netted off as there is not a legal right of offset.

Non-trading derivatives

Non-trading transactions comprise derivatives held for hedging purposes to manage the asset and liability positions of the Bank Company. Derivatives used to manage interest rate related positions include swaps, caps and floors and forward rate agreements. The foreign exchange rate positions are managed using forward currency transactions and swaps.

	2018 Fair value		2017 Fair value	
	Assets	**Liabilities**	Assets	Liabilities
Derivatives held for non-trading purposes				
Derivatives designated as cash flow hedges:				
Interest rate swaps	**32.7**	**(9.8)**	44.7	(4.9)
Derivatives designated as fair value hedges:				
Interest rate swaps	**10.3**	**(106.5)**	4.8	(136.9)
Derivatives held for non-trading purposes for which hedge accounting has not been applied:				
Interest rate swaps	**122.4**	**(140.1)**	147.4	(166.6)
Forward currency transactions	**-**	**(0.3)**	0.5	(0.4)
Total derivative assets/(liabilities) held for non-trading purposes	**165.4**	**(256.7)**	197.4	(308.8)
Total recognised derivative assets/(liabilities)	**165.4**	**(256.7)**	197.4	(308.8)

The derivatives designated as cash flow hedges are interest rate swaps used to hedge interest rate risk in retail operations. Cash flows are hedged by quarterly time periods for durations up to six years. During the year, there were no forecast transactions for which hedge accounting had previously been used but are no longer expected to occur.

In line with industry standards, credit valuation adjustments (CVAs) and debit valuation adjustments (DVAs) are applied to non-collateralised swaps representing the fair value measurement of counterparty risk. The net credit adjustment across the portfolio at the end of 2018 was £0.6m (2017: £0.7m). CVAs and DVAs are not applied to derivatives that are fully cash collateralised.

8. Equity shares

	2018	2017[1]
Investment securities:		
Listed	**0.4**	0.3
Unlisted	**26.0**	24.0
	26.4	24.3
Included above are the following unlisted trade investments:		
Visa International - (38,847 Series B Preference Shares) (2017: 38,847)	**26.0**	24.0

1. In accordance with the transitional provisions in IFRS 9, comparative figures have not been restated. See note 36 to the consolidated financial statements for details of changes in accounting policy.

Equity shares in 2018 are classified as FVTPL under IFRS 9 as no elections to measure at FVOCI were made. Equity shares in 2017 were classified as available-for-sale under IAS 39. The valuation technique used to calculate the fair value of equity shares is set out in note 33 to the consolidated financial statements.

9. Other assets

	2018			2017[1]
	Amortised cost	**Mandatorily measured at FVTPL**	**Total**	Loans and receivables
Amounts recoverable within one year				
Other assets	**9.2**	**-**	**9.2**	19.9
Amounts owed by Co-operative Group	**-**	**1.1**	**1.1**	-
Deferred consideration receivable	**4.5**	**-**	**4.5**	-
Total amounts recoverable within one year	**13.7**	**1.1**	**14.8**	19.9
Amounts recoverable after more than one year				
Amounts owed by Co-operative Group	**-**	**25.1**	**25.1**	55.0
Deferred consideration receivable	**-**	**-**	**-**	4.4
Total amounts recoverable after more than one year	**-**	**25.1**	**25.1**	59.4
Total other assets	**13.7**	**26.2**	**39.9**	79.3

1. In accordance with the transitional provisions in IFRS 9, comparative figures have not been restated. See note 36 to the consolidated financial statements for details of changes in accounting policy.

Amounts owed by Co-operative Group relates to the Surrendered Loss Debtor of £26.2m (2017: £55.0m).

10. Prepayments and accrued income

	2018	2017
Amounts recoverable within one year	**30.9**	24.0
Amounts recoverable after more than one year	**0.9**	0.6
Total prepayments and accrued income	**31.8**	24.6

11. Property, plant and equipment

2018	**Land and buildings**	**Leasehold improvements**	**Computers and other equipment**	**Assets in the course of construction**	**Total**
Cost					
At the beginning of the year	12.2	14.6	40.7	4.8	**72.3**
Additions	-	-	0.1	5.9	**6.0**
Impairment	-	(0.6)	(1.9)	(0.1)	**(2.6)**
Re-classified as held-for-sale	(3.9)	-	-	-	**(3.9)**
Transfer between categories	(2.9)	5.9	7.3	(10.3)	**-**
At the end of the year	**5.4**	**19.9**	**46.2**	**0.3**	**71.8**
Accumulated depreciation					
At the beginning of the year	2.3	-	25.6	-	**27.9**
Charge for the year	0.3	1.3	3.0	-	**4.6**
Impairment	-	(0.5)	(0.7)	-	**(1.2)**
Re-classified as held-for-sale	(0.3)	-	-	-	**(0.3)**
Transfer between categories	(1.4)	2.0	(0.6)	-	**-**
At the end of the year	**0.9**	**2.8**	**27.3**	**-**	**31.0**
Net book value					
At the end of the year	**4.5**	**17.1**	**18.9**	**0.3**	**40.8**
At the beginning of the year	9.9	14.6	15.1	4.8	44.4

2017	Land and buildings	Leasehold improvements	Computers and other equipment	Assets in the course of construction	Total
Cost					
At the beginning of the year	14.5	-	35.6	9.3	59.4
Additions	3.5	-	0.2	17.1	20.8
Impairment	-	-	-	(0.5)	(0.5)
Merger fair value write off[1]	(1.1)	-	-	-	(1.1)
Write off of fully depreciated assets	-	-	(2.8)	-	(2.8)
Re-classified as held-for-sale	(3.5)	-	-	-	(3.5)
Transfer between categories	(1.2)	14.6	7.7	(21.1)	-
At the end of the year	12.2	14.6	40.7	4.8	72.3
Accumulated depreciation					
At the beginning of the year	4.1	-	23.5	-	27.6
Charge for the year	0.5	-	3.7	-	4.2
Merger fair value write off[1]	(0.4)	-	-	-	(0.4)
Write off of fully depreciated assets	-	-	(2.8)	-	(2.8)
Re-classified as held-for-sale	(0.7)	-	-	-	(0.7)
Transfer between categories	(1.2)	-	1.2	-	-
At the end of the year	2.3	-	25.6	-	27.9
Net book value					
At the end of the year	9.9	14.6	15.1	4.8	44.4
At the beginning of the year	10.4	-	12.1	9.3	31.8

1. The remaining Britannia merger fair value was written off in 2017. Refer to note 34 to the consolidated financial statements in the 2017 Annual Report and Accounts for further information.

12. Intangible assets

	2018			2017		
	Internally generated intangible assets	**Other intangible assets**	**Total**	Internally generated intangible assets	Other Intangible assets	Total
Cost						
At the beginning of the year	**163.6**	**15.3**	**178.9**	162.8	41.8	204.6
Additions	**18.4**	**-**	**18.4**	18.0	4.3	22.3
Impairment	**(0.8)**	**-**	**(0.8)**	(3.1)	-	(3.1)
Merger fair value write off[1]	**-**	**-**	**-**	-	(41.8)	(41.8)
Write off of fully amortised assets	**-**	**-**	**-**	(3.1)	-	(3.1)
Transfer between categories	**(0.3)**	**0.3**	**-**	(11.0)	11.0	-
At the end of the year	**180.9**	**15.6**	**196.5**	163.6	15.3	178.9
Accumulated amortisation and impairment						
At the beginning of the year	**90.7**	**6.7**	**97.4**	73.5	31.0	104.5
Charge for the year	**23.8**	**2.9**	**26.7**	24.3	6.9	31.2
Merger fair value write off[1]	**-**	**-**	**-**	-	(35.2)	(35.2)
Write off of fully amortised assets	**-**	**-**	**-**	(3.1)	-	(3.1)
Transfer between categories	**-**	**-**	**-**	(4.0)	4.0	-
At the end of the year	**114.5**	**9.6**	**124.1**	90.7	6.7	97.4
Net book value						
At the end of the year	**66.4**	**6.0**	**72.4**	72.9	8.6	81.5
At the beginning of the year	72.9	8.6	81.5	89.3	10.8	100.1

1. The remaining Britannia merger fair value was written off in 2017. Refer to note 34 to the consolidated financial statements in the 2017 Annual Report and Accounts for further information.

Internally generated assets include £11.0m (2017: £18.1m) of assets in the course of construction. Other intangible assets wholly consist of purchased software licences.

13. Deposits by banks

	2018	2017
Deposits from other banks[1]	**1,433.5**	1,122.7

1. Obligatory netting arrangements are in place for repos and reverse repos transactions. As a result the amount reduced by netting is £100.0m (2017: £300.0m), with the opposing impact in Loans and advances to banks.

Included within deposits from other banks are liabilities of £468.8m (2017: £1,120.5m) secured on investment securities with a carrying value of £470.7m (2017: £1,206.3m) which have been sold under sale and repurchase agreements.

The Bank Company has undertaken a £960.0m drawing of the Bank of England's Term Funding Scheme in February 2018. The Bank Company is obliged to repay this borrowing by February 2022.

14. Debt securities in issue

Debt securities in issue comprise a secured covered bond of £600.0m at a coupon of 4.75%, having a maturity date in November 2021and requires the Bank Company to pay interest annually and repay contractual amounts due on the specified maturity date.

15. Other liabilities

	2018	2017
Amounts falling due within one year:		
ATM creditor	**-**	3.1
Other creditors	**82.5**	26.3
Amounts falling due after one year:		
Other creditors	**2.8**	4.5
Total other liabilities	**85.3**	33.9

Other creditors include finance lease obligations as follows:

	Present value of lease payments		Future minimum lease payments	
	2018	2017	2018	2017
Due between one year and five years	**0.1**	0.1	**0.1**	0.1
Due after five years	**1.0**	1.2	**1.4**	1.4
	1.1	1.3	**1.5**	1.5

The future minimum lease payments have been discounted at LIBOR (London Interbank Offered Rate) over the term of the lease to give the present value of these payments.

16. Accruals and deferred income

	2018	2017
Amounts falling due within one year:		
Accruals	**41.1**	49.7
Deferred income	**0.3**	0.2
	41.4	49.9
Amounts falling due after one year:		
Accruals	**6.9**	8.6
Deferred income	**1.5**	1.4
	8.4	10.0
Total accruals and deferred income	**49.8**	59.9

17. Provisions

2018	Property	FSCS levies	PPI	Conduct/ legal	Separation	Other	Total
At the beginning of the year	20.9	2.4	88.9	32.9	-	12.3	**157.4**
Provided/(released) in the year:							
Operating expenses	-	(1.6)	-	(0.4)	-	13.9	**11.9**
Net customer redress charge/(release)	-	-	39.5	(5.3)	-	-	**34.2**
Transfer between provision categories[1]	-	-	-	(1.3)	-	1.3	**-**
Utilised during the year	(5.7)	(0.8)	(60.6)	(17.2)	-	(16.2)	**(100.5)**
At the end of the year	**15.2**	**-**	**67.8**	**8.7**	**-**	**11.3**	**103.0**
Provisions were analysed as follows:							
Amounts falling due within one year	9.3	-	66.5	7.1	-	11.3	**94.2**
Amounts falling due after one year	5.9	-	1.3	1.6	-	-	**8.8**
Total provisions	**15.2**	**-**	**67.8**	**8.7**	**-**	**11.3**	**103.0**

1. Transfers made in the year comprised the Customers who Care VISA Flows provision in order to better reflect the nature of the provision.

2017	Property	FSCS levies	PPI	Conduct/ legal	Separation	Other	Total
At the beginning of the year	32.0	6.6	90.4	79.1	27.3	40.1	275.5
Provided/(released) in the year:							
Interest income	-	-	-	0.4	-	-	0.4
Operating expenses	(0.3)	-	-	1.0	(4.0)	19.9	16.6
Net customer redress charge/(release)	-	-	38.5	(11.5)	-	-	27.0
Utilised during the year	(10.8)	(4.2)	(40.0)	(36.1)	(23.3)	(47.7)	(162.1)
At the end of the year	20.9	2.4	88.9	32.9	-	12.3	157.4
Provisions were analysed as follows:							
Amounts falling due within one year	12.3	2.4	50.0	29.2	-	11.9	105.8
Amounts falling due after one year	8.6	-	38.9	3.7	-	0.4	51.6
Total provisions	20.9	2.4	88.9	32.9	-	12.3	157.4

Property

The Bank Company has a number of leasehold properties available for rent. Provisions are made when either the sub-lease income does not cover the rental expense or the property is vacant. The provision is based on the expected outflows during the remaining periods of the leases. In addition, dilapidation provisions are recorded to the extent that the Bank Company 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 Company has paid 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 was funded through loans from HM Treasury. The Bank Company had previously provided for its estimated share of interest levies based on its market participation.

During the year the FSCS loan balance with HM Treasury for the Bradford and Bingley claims was repaid in full. On 1 October 2018 the FSCS made the final payment of interest accrued up to the date of the loan repayment. As a result of the repayment of the interest by the FSCS to HM Treasury, there will be no further interest levies in relation to this. The Bank Company has therefore released the remaining £1.6m in the year, bringing the provision balance to £nil.

Payment Protection Insurance (PPI)

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

An additional provision of £39.5m was recognised in the year (2017: £38.5m), in respect of the total expected cost of carrying out work and paying compensation related to historical selling of PPI. The additional provision reflects increased complaint volumes ahead of the FCA imposed timebar of August 2019, the impact of marketing campaigns and the requirement to mail certain previously rejected complaints. As a result, the total provision recognised to date is £537.8m.

Conduct/legal provisions
The Bank Company released £5.3m (net) in the year (2017: £11.5m) for other customer redress charges. Included in the net release is a charge of £4.1m (2017: £nil) relating to possible mischarge of interest for further advances on mortgage products. Releases made during the year mainly comprise £1.9m (2017: £9.6m) for the mortgage remediation projects which were completed during the year and £1.5m Packaged Bank Accounts (2017: £nil) as the proactive remediation work is nearing completion.

Other
Other provisions include a net charge of £13.9m (2017: £19.9m) which mainly comprises movements in the bonus and severance costs provisions during the year.

18. Deferred tax
Deferred taxes are calculated on all temporary differences under the liability method using the most appropriate tax rate in respect of each temporary difference.

The UK corporation tax rate will reduce from 19% to 17% effective from 1 April 2020. A banking surcharge tax of 8% also applies to the Bank Company. Deferred tax has been calculated by reference to the most appropriate rate based on forecasts.

The movements in the deferred tax are as follows:

	2018	2017
Deferred tax at the beginning of the year	0.6	1.6
Credited/(charged) to the income statement:		
Current year	**77.2**	7.4
Prior year	**0.1**	(0.3)
Impact of corporation tax rate change	**(5.7)**	(1.2)
	71.6	5.9
Credited/(charged) to other comprehensive income:		
Cash flow hedges	**3.3**	8.8
FVOCI/available-for-sale	**0.5**	(1.1)
Unrealised appreciation on investments	**-**	5.7
Retirement benefits	**(114.7)**	(20.3)
	(110.9)	(6.9)
Deferred tax at the end of the year	**(38.7)**	0.6
Components of net deferred tax:		
Deferred tax asset	**133.9**	60.1
Deferred tax liability	**(172.6)**	(59.5)
	(38.7)	0.6

The deferred tax assets above includes an offset for those deferred tax liabilities that are permissible to be offset. Net deferred tax assets expected to be recoverable after one year are £nil (2017: £0.6m).

	2018	2017
Deferred tax comprises:		
Capital allowances on fixed assets and assets leased to customers	**95.2**	60.1
Losses	**38.7**	-
Retirement benefits	**(155.8)**	(39.4)
Cash flow hedges	**(6.7)**	(10.0)
Unrealised appreciation on investments	**(6.7)**	(6.1)
FVOCI/available-for-sale	**(3.4)**	(4.0)
	(38.7)	0.6

The deferred tax credit in the income statement comprises:

	2018	2017
Losses	**(38.7)**	-
Capital allowances on fixed assets and assets leased to customers	**(35.1)**	(21.4)
Retirement benefits	**1.7**	14.1
Unrealised appreciation on investments	**0.5**	0.1
Cash flow hedges	**-**	1.3
	(71.6)	(5.9)

Deferred tax assets totalling £363.6m (2017: £410.8m) have not been recognised where doubt exists over the availability of sufficient future taxable profits. Deferred tax of £357.2m and £6.4m has not been recognised in respect of trading losses of £2,008.0m and other temporary differences of £25.6m respectively.

19. Retirement benefits

Information on pensions is provided in note 28 of the consolidated financial statements.

20. Contingent liabilities

The tables below provide the contractual amounts and risk weighted amounts of contingent liabilities and commitments. The contractual amounts indicate the volume of business outstanding at the balance sheet date and do not represent amounts at risk. The risk weighted amounts have been calculated in accordance with the CRD IV rules.

The contingent liabilities, as detailed below, arise in the normal course of banking business and it is not practical to quantify their future financial effect.

	Audited	**Unaudited**	Audited	Unaudited
	Contractual amount 2018	**Risk weighted amount 2018**	Contractual amount 2017	Risk weighted amount 2017
Contingent liabilities arising from customer transactions:				
Guarantees and irrecoverable letters of credit	**12.4**	**3.7**	15.4	5.3
Other commitments arising from customer transactions:				
Undrawn formal standby facilities, credit lines and other commitments to lend (includes revocable and irrevocable commitments)[1]	**2,123.0**	**236.2**	2,263.2	265.3
	2,135.4	**239.9**	2,278.6	270.6

1. Undrawn loan commitments include revocable commitments which are unused credit card limits of £1,097.1m (2017: £1,211.2m).

Assets pledged

Assets are pledged as collateral under repurchase agreements with other banks. These deposits are not available to finance the Bank Company's day-to-day operations. Mandatory reserve deposits are also held with the Bank of England in accordance with statutory requirement. See note 24 to the Bank Company financial statements for further details of assets pledged.

Commitments under operating leases

Various properties and equipment are leased under non-cancellable operating lease arrangements. The leases have various terms, ranging from six months to 999 years. None of these leases are individually material and none have any material clauses. The table below discloses the minimum (undiscounted) operating lease payments that will be required over the remaining lives of the leases.

	Land and buildings 2018	Land and buildings 2017
Falling due:		
Within one year	**9.4**	8.7
Between one and five years	**31.4**	25.8
In five years or more	**49.1**	72.2
	89.9	106.7

A number of branch and office premises are leased under operating leases. The leases typically run for a period of up to 25 years, with an option to renew the lease after that period. Lease payments are generally reviewed every three to five years to reflect market rentals.

The total value of future minimum sub-lease payments expected to be received under non-cancellable sub-leases was £3.2m (2017: £3.1m).

Commitments to financially support subsidiary undertakings

Where relevant, the Bank Company has committed to financially support certain subsidiary undertakings.

Other contingent liabilities

In addition to the above, there are other contingent liabilities applicable to the Bank Company as listed below (for details, please refer to note 29 of the consolidated financial statements):

- Indemnification agreement;
- Separation costs agreement and IT services agreement;
- Conduct issues;
- Sale of the Bank's share in Visa Europe Limited (VE);
- Regulatory supervision and other investigations;
- Legal proceedings; and
- Mortgage securitisation representations and warranties (including Warwick Finance One, Two and Three).

21. Investments in subsidiaries/group undertakings

	2018			2017		
	Ordinary shares	**Capital contributions**	**Total**	Ordinary shares	Capital contributions	Total
At the beginning of the year	51.6	-	51.6	175.5	631.3	806.8
Additions	**-**	**-**	**-**	48.4	-	48.4
Repayments	**-**	**-**	**-**	(5.0)	-	(5.0)
Reclassification to amounts owed by other Co-operative Bank undertakings	**-**	**-**	**-**	-	(631.3)	(631.3)
Impairment charge	**(2.2)**	**-**	**(2.2)**	(167.3)	-	(167.3)
At the end of the year	**49.4**	**-**	**49.4**	51.6	-	51.6

Subsidiary undertakings

Subsidiary undertakings which are registered in England and operating in the UK:

	Ref		Shareholding	
			2018	2017
Co-operative Commercial Limited	1	Former investment company	**100%**	100%
Second Roodhill Leasing Limited	1	Leasing	**100%**	100%
Third Roodhill Leasing Limited	1	Leasing	**100%**	100%
Fourth Roodhill Leasing Limited	1	Leasing	**100%**	100%
Britannia Treasury Services Limited	1	Former Holding company	**100%**	100%
Britannia Development and Management Company Limited	1	Former property investment	**100%**	100%
Moorland Covered Bonds LLP	1	Mortgage acquisition and guarantor of covered bonds	**100%**	100%
Co-operative Bank Financial Advisers Limited	1	Inactive	**100%**	100%
Mortgage Agency Services Number One Limited	2	Former mortgage and syndicated lending	**100%**	100%
Mortgage Agency Services Number Two Limited	2	Former mortgage lending	**100%**	100%
Mortgage Agency Services Number Four Limited	2	Mortgage lending	**100%**	100%
Mortgage Agency Services Number Five Limited	2	Mortgage lending	**100%**	100%
Mortgage Agency Services Number Six Limited	2	Former mortgage lending	**100%**	100%
Platform Funding Limited	1	Mortgage lending	**100%**	100%

Registered in the Isle of Man and operating overseas:

Britannia International Limited	3	Former deposit taking

Britannia International Limited surrendered its Class 1 Deposit-Taking License to the Isle of Man Financial Supervision Commission during 2015. Any remaining customer accounts were closed and placed into a scheme to manage these funds.

Securitisation vehicles

The results of the following securitisation vehicles are consolidated into the results of the Bank Company:

	Ref		Shareholding	
			2018	2017
Silk Road Finance Number Four plc	4	Securitisation company	**100%**	100%
Calico Finance Number One DAC	5	Securitisation company	**100%**	100%

Securitisation vehicles are registered in England and operate in the UK, with the exception of Calico Finance Number One DAC, which is registered and operates in the Republic of Ireland. Note that following the call of Calico notes in 2016, the company was placed into liquidation in September 2018.

All of the above companies are related parties to the Bank Company. See note 22 to the Bank Company financial statements for the related party disclosures.

Joint ventures

The Bank Company has investments in the following joint ventures:

	Ownership	
	2018	2017
Britannia Personal Lending Limited	**-**	49%
Britannia New Homes (Scotland) Limited (Dormant)	**50%**	50%

In June 2018, the Bank Company sold its shares in Britannia Personal Lending Limited (BPL) to Bank of Scotland plc, generating a profit on sale of £0.6m.

Britannia New Homes (Scotland) Limited has its registered office at 140 West George Street, Glasgow, G2 2HG.

Dormant companies

The Bank Company has investments in the following dormant subsidiaries all of which are registered in England:

	Ref		Shareholding 2018	2017
Britannia Development and Management Limited	1	Formerly property development	**100%**	100%
Britannia Pension Trustees Limited	1	Pension scheme Participant	**100%**	100%
BPS Principal Employer Limited	1	Holding company	**100%**	100%
The Co-operative Bank Pension Trust Limited	1	Pension scheme Participant	**100%**	100%

Ref	Registered office at:
1	PO Box 101, 1 Balloon Street, Manchester, M60 4EP
2	1 Angel Square, Manchester, United Kingdom, M60 0AG
3	Estera Trust (Isle of Man) Limited, 33-37 Athol Street, Douglas, Isle of Man, IM1 1LB
4	35 Great St. Helen's, London, EC3A 6AP
5	Fourth Floor, 3 George’s Dock, IFSC, Dublin 1, Ireland

22. Related party transactions

Parent, subsidiary and ultimate controlling party

The ultimate parent undertaking of the Bank Company as at 31 December 2018 was The Co-operative Bank Holdings Limited. During 2017, The Co-operative Bank Holdings Limited became the new Holding Company for The Co-operative Bank plc and its subsidiaries by way of a share for share exchange with its shareholders. On 11 February 2019, The Co-operative Bank Finance Limited became the immediate parent of the Bank Company with Holding Company remaining the ultimate parent company of the Bank Company. See note 31 to the consolidated financial statements for further details.

As at 31 December 2018, the Group had two significant shareholders, SP Coop Investment, Ltd and Anchorage Illiquid Opportunities Offshore Master V.L.P, each holding over 20% of the B shares of the Holding Company.

The B Shareholders Agreement grants certain rights to shareholders, where the B shareholders are entitled to appoint up to two Directors to the Board of the Holding Company, and the Holding Company is entitled to appoint up to two Directors to the Board of the Bank Company, who are designated as B Directors of the Holding Company and Bank Company. Further information of the rights of the A and B shareholders and the B Shareholders Agreement are detailed in the Ownership section of the Corporate Governance Report.

On 6 March 2018, Goldentree Asset Management Lux S.A.R.L. reduced its Class A shareholding in the Holding Company and as a result, its entitlement to B shares reduced. As of that date, Goldentree Asset Management Lux S.A.R.L. which had been disclosed as a related party as at 31 December 2017, is no longer considered a related party on account of holding less than 20% of the B shares of the Holding Company.

Prior to the Restructuring and Recapitalisation, Co-operative Group was a significant shareholder of the Bank Company, and had the right to Bank Board representation. Therefore Co-operative Group has been considered a related party of the Bank Company during 2017 up until the Restructuring and Recapitalisation on 1 September 2017.

Balances with Holding Company and other Co-operative Bank undertakings
The following tables show the closing balance with The Co-operative Bank plc.

Amounts owed by Co-operative Bank undertakings	2018	2017
Amounts owed by Co-operative Bank subsidiaries (excluding special purpose entities)	**1,275.7**	1,305.4
Amounts owed by Co-operative Bank subsidiaries - special purpose entities	**30.7**	16.8
	1,306.4	1,322.2
Investment securities held by Co-operative Bank in subsidiaries – special purpose entities	**809.5**	1,350.0
	2,115.9	2,672.2

Amounts owed to Holding Company and Co-operative Bank undertakings	2018	2017
Amounts owed to Co-operative Bank subsidiaries (excluding special purpose entities)	**1,194.7**	1,206.9
Amounts owed to Co-operative Bank subsidiaries - special purpose entities	**784.4**	1,298.8
	1,979.1	2,505.7
Cash balances deposited with the Bank Company by Co-operative Bank subsidiaries (excluding special purpose entities)	**0.5**	0.5
Cash balances deposited with the Bank Company by The Co-operative Bank Holdings Limited	**0.2**	0.2
	1,979.8	2,506.4

During the year a number of subsidiaries were dissolved, which previously would have been related parties of the Bank Company.

The following tables show the value of transactions with The Co-operative Bank plc undertakings during the year.

2018	Interest and fees paid to Bank Company	Interest and fees received from Bank Company	Rent received from Bank Company
Transactions with Co-operative Bank subsidiaries (excluding special purpose entities)	**31.1**	**23.4**	**-**
Transactions with Co-operative Bank subsidiaries - special purpose entities	**26.0**	**25.5**	**-**
	57.1	**48.9**	**-**

2017	Interest and fees paid to Bank Company	Interest and fees received from Bank Company	Rent received from Bank Company
Transactions with Co-operative Bank subsidiaries (excluding special purpose entities)	30.8	29.6	0.5
Transactions with Co-operative Bank subsidiaries - special purpose entities	25.7	23.2	-
	56.5	52.8	0.5

Transactions with Directors, key management personnel and close family
Details of the Bank Company's transactions with Directors, key management personnel and close family are as set out in note 31 to the consolidated financial statements.

23. Share capital
Information on share capital is provided in note 32 to the consolidated financial statements.

24. 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.

			Measured at fair value				
Balance sheet categories	Note	**Amortised cost**	**FVOCI**	**FVTPL – designated**	**FVTPL – mandatorily measured**	**Derivatives in a hedging relationship**	**Total**
2018							
Assets							
Cash and balances at central banks	3	1,843.8	-	-	-	-	**1,843.8**
Loans and advances to banks	4	380.4	-	-	-	-	**380.4**
Loans and advances to customers	5	17,467.3	-	144.7	2.3	-	**17,614.3**
Investment securities	6	898.6	1,842.4	-	3.5	-	**2,744.5**
Derivative financial instruments	7	-	-	-	122.4	43.0	**165.4**
Equity shares	8	-	-	-	26.4	-	**26.4**
Amounts owed by other Co-operative Bank undertakings		1,306.4	-	-	-	-	**1,306.4**
Other assets	9	13.7	-	-	26.2	-	**39.9**
Total financial assets		**21,910.2**	**1,842.4**	**144.7**	**180.8**	**43.0**	**24,121.1**
Non-financial assets							**877.5**
Total assets							**24,998.6**
Liabilities							
Deposits by banks	13	1,433.5	-	-	-	-	**1,433.5**
Customer accounts		18,736.4	-	-	-	-	**18,736.4**
Debt securities in issue	14	601.5	-	-	-	-	**601.5**
Derivative financial instruments	7	-	-	-	140.4	116.3	**256.7**
Amounts owed to other Co-operative Bank undertakings		1,979.1	-	-	-	-	**1,979.1**
Other liabilities	15	85.3	-	-	-	-	**85.3**
Total financial liabilities		**22,835.8**	**-**	**-**	**140.4**	**116.3**	**23,092.5**
Non-financial liabilities							**199.1**
Total liabilities							**23,291.6**
Capital and reserves attributable to the Bank Company's equity holders							**1,707.0**
Total liabilities and equity							**24,998.6**

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

	Note	Held for trading	Designated at fair value	Loans and receivables	Available-for-sale	Liabilities at amortised cost	Derivatives in a hedging relationship	Total
2017[1]								
Assets								
Cash and balances at central banks	3	-	-	4,032.0	-	-	-	4,032.0
Loans and advances to banks	4	-	-	460.3	-	-	-	460.3
Loans and advances to customers	5	3.2	175.0	16,430.0	-	-	-	16,608.2
Investment securities	6	-	-	1,450.0	2,287.7	-	-	3,737.7
Derivative financial instruments	7	147.9	-	-	-	-	49.5	197.4
Equity shares	8	-	-	-	24.3	-	-	24.3
Amounts owed by other Co-operative Bank undertakings		-	-	1,322.2	-	-	-	1,322.2
Other assets	9	-	-	79.3	-	-	-	79.3
Total financial assets		151.1	175.0	23,773.8	2,312.0	-	49.5	26,461.4
Non-financial assets								438.3
Total assets								26,899.7
Liabilities								
Deposits by banks	13	-	-	-	-	1,122.7	-	1,122.7
Customer accounts		-	-	-	-	20,635.7	-	20,635.7
Debt securities in issue	14	-	-	-	-	600.7	-	600.7
Derivative financial instruments	7	167.0	-	-	-	-	141.8	308.8
Amounts owed to other Co-operative Bank undertakings		-	-	-	-	2,505.7	-	2,505.7
Other liabilities	15	-	-	-	-	33.9	-	33.9
Total financial liabilities		167.0	-	-	-	24,898.7	141.8	25,207.5
Non-financial liabilities								228.6
Total liabilities								25,436.1
Capital and reserves attributable to the Bank Company's equity holders								1,463.6
Total liabilities and equity								26,899.7

1. In accordance with the transitional provisions in IFRS 9, comparative figures have not been restated. See note 36 to the consolidated financial statements for details of changes in accounting policy.

a) Use of financial assets and liabilities
Refer to note 33 to the consolidated financial statements for details of the use of financial instruments.

b) Valuation of financial assets and liabilities measured at fair value
The carrying values of financial assets and liabilities measured at fair value are determined in compliance with the accounting policies in note 1 to the consolidated financial statements and analysed in the following tables 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

There were no transfers between level 1 and 2 during the year.

	Fair value at end of the reporting period using:			
	Level 1	**Level 2**	**Level 3**	**Total**
2018				
Non-derivative financial assets				
FVOCI:				
Investment securities	1,443.1	-	399.3	**1,842.4**
FVTPL – designated:				
Loans and advances to customers	-	141.9	2.8	**144.7**
FVTPL – mandatorily measured:				
Loans and advances to customers	-	-	2.3	**2.3**
Investment securities	-	-	3.5	**3.5**
Equity shares	0.4	-	26.0	**26.4**
Other assets	-	-	26.2	**26.2**
Derivative financial assets	-	165.4	-	**165.4**
Non-financial assets				
Investment properties	-	-	2.3	**2.3**
Total assets carried at fair value	**1,443.5**	**307.3**	**462.4**	**2,213.2**
Derivative financial liabilities	-	256.7	-	**256.7**
Total liabilities carried at fair value	**-**	**256.7**	**-**	**256.7**

	Fair value at end of the reporting period using:			
	Level 1	Level 2	Level 3	Total
2017[1]				
Non-derivative financial assets				
Held for trading:				
Loans and advances to customers	-	3.2	-	3.2
Designated at fair value:				
Loans and advances to customers	-	171.2	3.8	175.0
Available-for-sale financial assets:				
Investment securities	1,462.3	1.9	823.5	2,287.7
Equity shares	0.3	-	24.0	24.3
Derivative financial assets	-	197.4	-	197.4
Non-financial assets				
Investment properties	-	-	2.3	2.3
Total assets carried at fair value	1,462.6	373.7	853.6	2,689.9
Derivative financial liabilities	-	308.8	-	308.8
Total liabilities carried at fair value	-	308.8	-	308.8

1. In accordance with the transitional provisions in IFRS 9, comparative figures have not been restated. See note 36 to the consolidated financial statements for details of changes in accounting policy.

Key considerations in the calculation of fair values for financial assets and liabilities measured at fair value are as follows:

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

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

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

- **Loans and advances to customers**
  Loans and advances to customers primarily comprise of corporate loans of £131.7m as at 31 December 2018 (2017: £158.1m) which are fair valued through profit or loss using observable inputs. Loans held at fair value are valued at the sum of all future expected cash flows, discounted using a yield curve based on observable market inputs.

- **Derivative financial instruments**
  Over-the-counter (i.e. non-exchange traded) derivatives are valued using valuation models which are based on observable market data. Valuation models calculate the present value of expected future cash flows, based upon 'no arbitrage' principles. The Bank Company 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.

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

- **Investment securities**
  Investment securities comprise of RMBS of £399.3m (FVOCI) and £3.5m (FVTPL – mandatorily measured) as at 31 December 2018 (2017 AFS: £823.5m). An independent third party valuation agent is used to provide prices for the rated RMBS obtained from large financial institutions. These prices are indicative values only and do not represent an offer to purchase the securities. These RMBS represent the Bank Company's interest in unconsolidated structured entities.

  A 1% increase or decrease in the price of the notes will result in the value increasing or decreasing by approximately £4.0m respectively.

- **Equity shares**
  Equity shares comprise of US Dollar denominated convertible preference shares in Visa International, which are classified as FVTPL – designated, with any movements in fair value being recognised through profit or loss. The fair value of the Visa International shares has been calculated by taking the period end NYSE share price and discounting for illiquidity and clawback.

  If the illiquidity premium to the discount rate was assumed to be double, it would result in a reduction in the overall fair value of the equity shares of £7.2m (27.7%) as at 31 December 2018.

- **Other assets**
  Other assets comprise of the Surrendered Loss Debtor of £26.2m as at 31 December 2018. This financial instrument was reclassified from 'amortised cost' under IAS 39 to 'FVTPL – mandatorily measured' under IFRS 9 (see note 36 to the consolidated financial statements for further details). The 31 December 2017 amortised cost carrying value under IAS 39 was £55.0m with disclosure fair value of £53.5m. The fair value was determined by discounting the expected cash flows under the terms of the agreement with Co-operative Group. Cash flows are discounted at a discount rate reflecting the yield of the longest maturity Co-operative Group bond in issue (adjusted to reflect the weighted average maturity of cash flows due from Co-operative Group), plus a premium to estimate the uncertainties associated with the matters set out in note 2.2.5 to the consolidated financial statements. The premium is calculated applying risk parameter estimation theory using observable inputs from related (but not identical) financial instruments or indices.

- **Investment properties**
  Investment properties within level 3 are valued by using recent valuations of individual assets within the portfolio, 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 end of the previous year	IFRS 9 opening balance adjustments[1]	Fair value at the beginning of the year	Purchases and transfers in	Sales, transfers out and repayments	Other comprehen-sive income	Income statement	Fair value at the end of the year
2018								
Loans and advances to customers	3.8	2.6	6.4	-	(1.3)	-	-	**5.1**
Investment securities	823.5	-	823.5	-	(410.1)	(11.6)	1.0	**402.8**
Equity shares	24.0	-	24.0	-	-	-	2.0	**26.0**
Investment properties	2.3	-	2.3	-	(0.1)	-	0.1	**2.3**
Other assets	-	42.8	42.8	-	5.3	-	(21.9)	**26.2**
	853.6	**45.4**	**899.0**	**-**	**(406.2)**	**(11.6)**	**(18.8)**	**462.4**
2017								
Loans and advances to customers	4.9	-	4.9	-	(0.9)	-	(0.2)	3.8
Investment securities	1,307.4	-	1,307.4	4.2	(500.8)	5.0	7.7	823.5
Equity shares	19.3	-	19.3	-	-	4.7	-	24.0
Investment properties	2.2	-	2.2	-	-	-	0.1	2.3
Other assets	-	-	-	-	-	-	-	-
	1,333.8	-	1,333.8	4.2	(501.7)	9.7	7.6	853.6

1. Loans and advances to customers adjustment all relates to reclassification from 'Loans and receivables' under IAS 39 to 'FVTPL – mandatorily measured' under IFRS 9. Other assets adjustment of £42.8m is comprised of £55.0m reclassification from 'Loans and receivables' under IAS 39 to 'FVTPL – mandatorily measured' under IFRS 9 and £(12.2m) remeasurement. See note 36 to the consolidated financial statements for details of changes in accounting policy.

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

The carrying values of financial assets and liabilities measured at amortised cost are determined in compliance with the accounting policies in note 1 to the consolidated financial statements and their fair values are analysed in the following tables by the three level fair value hierarchy set out above. There were no transfers between level 1 and 2 during the year.

		Fair Value				
	Total carrying value	**Level 1**	**Level 2**	**Level 3**	**Items where fair value approximates carrying value**	**Total**
2018						
Financial assets						
Cash and balances at central banks	**1,843.8**	-	-	-	1,843.8	**1,843.8**
Loans and advances to banks	**380.4**	-	-	-	380.4	**380.4**
Loans and advances to customers	**17,467.3**	-	-	16,004.2	1,289.8	**17,294.0**
Investment securities	**898.6**	-	-	891.8	-	**891.8**
Amounts owed by other Co-operative Bank undertakings	**1,306.4**	-	659.5	-	704.0	**1,363.5**
Other assets	**13.7**	-	-	-	13.7	**13.7**
Financial liabilities						
Deposits by banks	**1,433.5**	-	1,436.4	-	2.5	**1,438.9**
Customer accounts	**18,736.4**	-	-	4,163.0	14,582.7	**18,745.7**
Debt securities in issue	**601.5**	640.8	-	-	-	**640.8**
Amounts owed to other Co-operative Bank undertakings	**1,979.1**	-	-	1,176.2	805.5	**1,981.7**
Other liabilities	**85.3**	-	-	-	85.3	**85.3**

		Fair Value				
	Total carrying value	Level 1	Level 2	Level 3	Items where fair value approximates carrying value	Total
2017						
Financial assets						
Cash and balances at central banks	4,032.0	-	-	-	4,032.0	4,032.0
Loans and advances to banks	460.3	-	9.3	-	450.5	459.8
Loans and advances to customers	16,430.0	-	-	14,594.7	1,604.0	16,198.7
Investment securities	1,450.0	-	-	1,448.8	-	1,448.8
Amounts owed by other Co-operative Bank undertakings	1,322.2	-	658.9	-	720.3	1,379.2
Other assets	79.3	-	-	53.5	24.3	77.8
Financial liabilities						
Deposits by banks	1,122.7	-	1,115.9	-	3.4	1,119.3
Customer accounts	20,635.7	-	-	5,452.1	15,203.9	20,656.0
Debt securities in issue	600.7	658.2	-	-	-	658.2
Amounts owed to other Co-operative Bank undertakings	2,505.7	-	-	1,173.6	1,321.5	2,495.1
Other liabilities	33.9	-	-	-	33.9	33.9

Key considerations in the calculation of fair values of financial instruments measured at amortised cost are as follows:

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 banks/deposits by banks**
  Loans and advances to banks comprise of 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.

- **Amounts owed by other Co-operative Bank undertakings**
  Amounts owed by other Co-operative Bank undertakings comprise of debt securities and subordinated debt held in the Bank Company's own securitisation vehicles. Fair value is based on available market prices; where these are not available quoted market prices for similar debt securities, with adjustments to take into account the subordination of the particular loan note, have been used to estimate fair value.

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

- **Loans and advances to customers**
  The fair value of loans and advances to customers in total is 99.0% of the carrying value as at 31 December 2018 (2017: 98.6%). The increase in 2018 is due to a combination of the growth of higher-valued Retail mortgages and reduction of the lower-valued Optimum mortgages and Corporate loans.

  The overall fair value is less than par primarily due to two main factors:
  - customer interest rates are below the market rate for the period until expected maturity or the repricing date, if earlier;
  - credit risk adjustments due to incurred and expected future credit losses.

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

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

  Other reporting entities may use different valuation methodologies and assumptions in determining fair values for which no observable market prices are available.

- **Investment securities**
  Investment securities comprise of:
  - RMBS measured at amortised cost of £77.1m as at 31 December 2018 (2017: £87.0m), being a 5% regulatory holding of the rated notes of the Warwick Finance Three unconsolidated structured entity. The remaining 95% is privately held therefore there are no available market prices. An in-house model is used that sources independent market data for disclosure purposes only.
  - Securities measured at amortised cost of £12.0m as at 31 December 2018 (2017: £13.0m) as the quoted price is in an inactive market.
  - Investment securities measured at amortised cost of £809.5m as at 31 December 2018 (2017: £1,350.0m), being a 100% holding of the Silk Road 4 buyback. As 100% is held, there are no available market prices. An in-house model is used that sources independent market data for disclosure purposes only.

- **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.

- **Amounts owed to other Co-operative Bank undertakings**
  Amounts owed to other Co-operative Bank undertakings comprise of deemed loans owed to the Bank Company's own securitisation vehicles; these have been modelled using expected cash flows, based on redemption profiles, discounted at a market rate.

d) Fair value of transferred assets and associated liabilities

Assets pledged

Assets are pledged as collateral under repurchase agreements with other banks. These deposits are not available to finance the Bank Company's day-to-day operations.

	Carrying amount of assets not derecognised	Carrying amount of associated liabilities	Fair value of assets not derecognised	Fair value of associated liabilities	Net fair value position
2018					
Investments securities sold under repurchase agreements	593.0	568.8	593.0	568.8	**24.2**
2017					
Investments securities sold under repurchase agreements	1,595.4	1,120.4	1,595.4	1,120.4	475.0

Assets sold under repurchase agreements include mortgage backed securities (£257.3m of assets and associated liabilities of £235.4m) and UK government gilts and a European Investment Bank (EIB) bond (£335.7m of assets and associated liabilities of £333.4m).

25. Analysis of credit risk exposure

2018	Loans and advances to banks	Loans and advances to customers	Investment securities	Derivative financial instruments	Other assets	Total
Analysis of balances in notes	4	5	6	7	9	
Gross balance	380.4	17,666.0	2,744.5	165.4	39.9	**20,996.2**
Less: allowance for losses	-	(51.7)	-	-	-	**(51.7)**
Net balance	**380.4**	**17,614.3**	**2,744.5**	**165.4**	**39.9**	**20,944.5**
Analysis of credit risk exposure						
Gross balance						
Stage 1 - 12 month ECL	380.4	16,546.0	2,741.0	-	13.7	**19,681.1**
Stage 2 - Lifetime ECL	-	545.5	-	-	-	**545.5**
Stage 3 - Lifetime ECL (credit impaired)	-	133.7	-	-	-	**133.7**
Purchased or Credit impaired assets	-	293.8	-	-	-	**293.8**
FVTPL financial assets	-	147.0	3.5	165.4	26.2	**342.1**
	380.4	**17,666.0**	**2,744.5**	**165.4**	**39.9**	**20,996.2**
Credit commitments						
Stage 1 - 12 month ECL	-	2,221.9	-	-	-	**2,221.9**
Stage 2 - Lifetime ECL	-	22.1	-	-	-	**22.1**
Stage 3 - Lifetime ECL (credit impaired)	-	1.1	-	-	-	**1.1**
Purchased or Credit impaired assets	-	2.3	-	-	-	**2.3**
FVTPL financial assets	-	-	-	-	-	**-**
	-	**2,247.4**	**-**	**-**	**-**	**2,247.4**
Gross credit risk exposure	**380.4**	**19,913.4**	**2,744.5**	**165.4**	**39.9**	**23,243.6**
Less: allowance for losses						
Stage 1 - 12 month ECL	-	(11.8)	-	-	-	**(11.8)**
Stage 2 - Lifetime ECL	-	(5.0)	-	-	-	**(5.0)**
Stage 3 - Lifetime ECL (credit impaired)	-	(30.6)	-	-	-	**(30.6)**
Purchased or Credit impaired assets	-	(4.3)	-	-	-	**(4.3)**
FVTPL financial assets	-	-	-	-	-	**-**
	-	**(51.7)**	**-**	**-**	**-**	**(51.7)**
Net credit risk exposure	**380.4**	**19,861.7**	**2,744.5**	**165.4**	**39.9**	**23,191.9**

Included within the gross credit risk table above are the following financial instruments which are classified at FVTPL:

	Maximum exposure to credit risk	**Carrying amount**	**Fair Value of Collateral held**
Derivatives	165.4	165.4	-
Other assets	26.2	26.2	-
Financial assets designated at FVTPL:			
Loans and advances to customers	147.0	147.0	63.5
Investment securities	3.5	3.5	-
	342.1	**342.1**	**63.5**

2017	Loans and advances to banks	Loans and advances to customers	Investment securities – Loans and receivables	Investment securities – Available-for-sale	Derivative financial instruments	Total
Analysis of balance in note	4	5	6	6	7	
Gross balance	460.3	16,687.1	1,450.0	2,287.7	197.4	21,082.5
Less: allowance for losses	-	(78.9)	-	-	-	(78.9)
	460.3	16,608.2	1,450.0	2,287.7	197.4	21,003.6
Analysis of credit risk exposure						
Not impaired	460.3	16,290.2	1,450.0	2,287.7	197.4	20,685.6
Impaired	-	396.9	-	-	-	396.9
	460.3	16,687.1	1,450.0	2,287.7	197.4	21,082.5
Credit commitments	-	2,411.0	-	-	-	2,411.0
Gross credit risk exposure	460.3	19,098.1	1,450.0	2,287.7	197.4	23,493.5
Less allowances for losses	-	(78.9)	-	-	-	(78.9)
Net credit risk exposure	460.3	19,019.2	1,450.0	2,287.7	197.4	23,414.6

The Credit Risk section within risk management applies to the Bank Company where relevant and therefore no additional disclosures are included in this note.

26. Events after the balance sheet date

On 11 February 2019, The Co-operative Bank Finance Limited became the immediate parent of the Bank Company, with the Holding Company remaining the ultimate parent of the Bank Company. See note 35 to the consolidated financial statements for further details.

The Co-operative Bank Holdings Limited balance sheet
At 31 December 2018
£millions

	Note	**2018**	2017
Assets			
Loans and advances to banks	2	**0.2**	0.2
Investments in subsidiaries/group undertakings	3	**333.0**	333.0
Total assets		**333.2**	333.2
Total liabilities		**-**	-
Capital and reserves attributable to the Holding Company's equity holders			
Ordinary share capital	4	**0.9**	0.9
Share premium account	4	**313.8**	313.8
Merger relief reserve		**18.5**	18.5
Total equity		**333.2**	333.2
Total liabilities and equity		**333.2**	333.2

Net profit attributable to equity holders of the Holding Company for the year is £nil (period from incorporation on 13 July 2017 to 31 December 2017: £nil).

The notes on pages 213 to 214 form part of these financial statements.

Approved by the Board on 27 February 2019:

Robert Dench
Chairman

Andrew Bester
Chief Executive Officer

The Co-operative Bank Holdings Limited statement of cash flows
For the year ended 31 December 2018
£millions

	Year ended 31 December 2018	Period from incorporation on 13 July 2017 to 31 December 2017
Cash flows used in operating activities:		
Profit before taxation	-	-
Increase in loans and advances to banks	-	(0.2)
Net movement of other assets and other liabilities	-	(0.1)
Net cash flows used in operating activities	-	(0.3)
Cash flows used in investing activities:		
Investment in subsidiaries	-	(250.0)
Net cash flows used in investing activities	-	(250.0)
Cash flows from financing activities:		
Proceeds from issue of shares	-	250.3
Net cash flows from financing activities	-	250.3
Net increase in cash and cash equivalents	-	-
Increase in cash and cash equivalents		
Cash and cash equivalents at the beginning of the year/period	-	-
Cash and cash equivalents at the end of the year/period	-	-

The notes on pages 213 to 214 form part of these financial statements.

The Co-operative Bank Holdings Limited statement of changes in equity
For the year ended 31 December 2018
£millions

	Attributable to equity holders of the Holding Company			
2018	**Share capital**	**Share premium**	**Merger relief reserve**	**Total equity**
Balance at the beginning of the year	0.9	313.8	18.5	**333.2**
Total comprehensive income for the year	-	-	-	-
Balance at the end of the year	**0.9**	**313.8**	**18.5**	**333.2**

	Attributable to equity holders of the Holding Company			
2017	Share capital	Share premium	Merger relief reserve	Total equity
Balance at incorporation on 13 July 2017	-	-	-	-
Total comprehensive income for the period	-	-	-	-
Issuance of share capital and bank acquisition	0.9	313.8	18.5	333.2
Balance at the end of the period	0.9	313.8	18.5	333.2

The notes on pages 213 to 214 form part of these financial statements.

1. Basis of preparation

The Co-operative Bank Holdings Limited was incorporated in the UK and registered in England and Wales under the name of Balloon Street Holdings Limited on 13 July 2017. The name of the Holding Company was changed from Balloon Street Holdings Limited to The Co-operative Bank Holdings Limited on 1 September 2017. On 1 September 2017 the Holding Company became the new Holding Company for The Co-operative Bank plc and its subsidiaries by way of a share for share exchange.

The Holding Company financial statements have been prepared under the historic cost convention and approved by the Directors in accordance with IFRS as issued by the International Accounting Standards Board (IASB), and as adopted by the European Union (EU). The first accounting period for the Holding Company ran from 13 July 2017 to 31 December 2017.

On including its financial statements within the Group's Annual Report and Accounts, the Holding Company is taking advantage of the exemption in Section 408 of the Companies Act 2006 not to present its individual income statement and related notes.

Accounting policies outlined in note 1 to the consolidated financial statements also apply to the Holding Company.

2. Loans and advances to banks

	2018	2017
Loans and advances to banks	0.2	0.2

This balance is held with The Co-operative Bank plc.

3. Investments in subsidiaries/group undertakings

	2018	2017
Investments in subsidiaries/group undertakings	333.0	333.0

At 31 December 2018, the Holding Company owned 100% of the share capital of The Co-operative Bank plc and 100% of The Co-operative Bank Finance Limited. The Co-operative Bank plc is incorporated in the UK and registered in England and Wales and its principal activity is to provide a range of banking and financial services. The Co-operative Bank Finance Limited was incorporated as a subsidiary in October 2018, is incorporated in the UK and registered in England and Wales and its principal activity will be to issue debt for the Bank Company. The Co-operative Bank plc has a number of subsidiary companies of its own, details of which are outlined in note 21 to the Bank Company financial statements. The Co-operative Bank plc was sold to The Co-operative Bank Finance Limited on 11 February 2019, see note 35 to the consolidated financial statements for more information.

4. Share capital

2018	**No. of A shares (millions)**	**A share capital**	**No. of B shares**	**B share capital**	**Total share capital**
Allotted, called up and fully paid					
At the beginning of the year	9,029.1	0.9	66	-	**0.9**
Issued during the year	**-**	**-**	20	**-**	**-**
Cancelled during the year	**-**	**-**	(4)	**-**	**-**
At the end of the year	**9,029.1**	**0.9**	**82**	**-**	**0.9**

Share premium account	
At the beginning and at the end of the year	**313.8**

2017	No. of A shares (millions)	A share capital	No. of B shares	B share capital	Total share capital
Allotted, called up and fully paid					
At the beginning of the period	-	-	-	-	-
Issued during the period	9,029.1	0.9	67	-	0.9
Cancelled during the period	-	-	(1)	-	-
At the end of the period	9,029.1	0.9	66	-	0.9

Share premium account	
At the beginning of the period	-
Premium on shares issued during the period	313.8
At the end of the period	313.8

On 13 July 2017, The Co-operative Bank Holdings Limited was incorporated with 451,457 ordinary shares of £0.10 each. On 1 September 2017, each incorporation share was sub-divided by 1,000 into 451,457,000 ordinary shares of £0.0001 each and reclassified as A shares. In addition, on 1 September 2017, The Co-operative Bank Holdings Limited became the new holding company for The Co-operative Bank plc and its subsidiaries by way of a share for share exchange with its shareholders. The Co-operative Bank Holdings Limited allotted and issued an additional 8,577,673,200 A shares of £0.0001 each and 65 fully paid B redeemable preference shares of £0.01 each to qualifying A shareholders as part of the Restructuring and Recapitalisation of The Co-operative Bank plc. The merger relief reserve was recognised on the issuance of Holding Company shares in exchange for the acquisition of the entire share capital of The Co-operative Bank plc.

The holders of the ordinary A shares hold limited voting rights but are entitled to participate in distributions and to receive a dividend on liquidation. The B shareholders have one vote for every share held and also benefit from certain governance, notification and approval rights with respect to the new Holding Company group but will have no rights to distributions, other than on exit in an amount of £25m in aggregate, subject to achieving a minimum valuation threshold.

During the year 10 new B shares were acquired by each of Anchorage Illiquid Opportunities Offshore Master V, L.P and BlueMountain Capital Management LLC and 2 B shares were disposed of by each of Goldentree Asset Management Lux S.A.R.L. and Cyrus Investment Management LLP.

5. Related party transactions

Parent, subsidiary and ultimate controlling party

The ultimate parent undertaking of the Group is The Co-operative Bank Holdings Limited. During 2017, The Co-operative Bank Holdings Limited became the new Holding Company for The Co-operative Bank plc and its subsidiaries by way of a share for share exchange with its shareholders.

As at 31 December 2018, the Holding Company had two significant shareholders, SP Coop Investment, Ltd and Anchorage Illiquid Opportunities Offshore Master V, L.P each holding over 20% of the B shares.

Anchorage Illiquid Opportunities Offshore Master V, L.P increased its shareholding in 2018 and as a result increased it’s holding to above the 20% level.

Goldentree Asset Management Lux S.A.R.L. reduced its Class A shareholding in the Holding Company and as a result, its entitlement to B shares reduced. Goldentree Asset Management Lux S.A.R.L. had been disclosed as a related party as at 31 December 2017, but is no longer considered a related party on account of holding less than 20% of the B shares of the Holding Company.

Balances with related parties

The following table shows the value of transactions with related parties during the year:

	2018	2017
Amounts owed by The Co-operative Bank plc	**0.2**	0.2

The subsidiaries of The Co-operative Bank plc as detailed in note 21 to the Bank Company financial statements, as well as all Directors and key management personnel of the Group, are considered to be related parties of the Holding Company. Further details are available in note 31 to the consolidated financial statements.

6. Events after the balance sheet date

On 11 February 2019, The Co-operative Bank Finance Limited became the immediate parent of the Bank Company, with the Holding Company remaining the ultimate parent of the Bank Company. See note 35 to the consolidated financial statements for further details.

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SHAREHOLDER INFORMATION

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FORWARD-LOOKING STATEMENTS

Caution about forward-looking statements

This document contains forward-looking statements with respect to the business, strategy and plans of The Co-operative Bank Holdings Limited and The Co-operative Bank plc (including its 2019-2023 Financial Plan or the Plan) and its current targets, goals and expectations relating to its future financial condition, performance, developments and/or prospects. 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. Examples of such statements include statements regarding the Group's future financial position and commitments in connection with the Plan and other statements that are not historical fact.

Limitations inherent to forward-looking statements

The Bank cautions readers that these forward–looking statements are not historical facts or guarantees of future performance. By their nature, forward-looking statements involve risk and uncertainty because they are based on current plans, estimates, targets, projections, views and assumptions and are subject to significant inherent risks, uncertainties and other factors both external and internal relating to the Group's Plan, strategy or operations, which may result in the Group being unable to achieve the current targets, predictions, expectations and other anticipated outcomes expressed or implied by these forward-looking statements. In addition, certain of these disclosures are dependent on choices relying on key model characteristics and assumptions and are subject to various limitations, including assumptions and estimates made by management. Accordingly, undue reliance should not be placed on forward-looking statements.

Forward-looking statements speak only as at today

Any forward-looking statements made or contained in this Annual Report and Accounts speak only as of the date of this Annual Report and Accounts and it should not be assumed that they have been revised or updated in the light of new information of future events. Except as required by the Prudential Regulation Authority, the Financial Conduct Authority, the London Stock Exchange or applicable law, the Group expressly disclaims any obligation or undertaking to release publicly any updates or revisions to any forward-looking statements contained in this document as a result of new information or to reflect any change in the Group's expectations with regard thereto or any change in events, conditions or circumstances on which any such statement is based. The reader should, however, consider any additional disclosures that the Group has made or may make in documents it has published or may publish via the Regulatory News Service of the London Stock Exchange.

No offer of securities

The information in this Annual Report and Accounts is not, nor should be construed as, an offer of, or solicitation of an offer to purchase or subscribe for, any securities to any person in any jurisdiction. In particular, this Annual Report and Accounts does not constitute an offer for sale of, or a solicitation to purchase or subscribe for, any securities in the United States. No securities of the Group have been, or will be, registered under the US Securities Act of 1933, as amended (the Securities Act), and securities of the Group may not be offered or sold in the United States absent an exemption from, or in a transaction not subject to, the registration requirements of the Securities Act and in compliance with any applicable securities laws of any state or other jurisdiction of the United States.

GLOSSARY

The following glossary defines terminology used within the Annual Report and Accounts of The Co-operative Bank Holdings Limited and The Co-operative Bank plc to assist the reader and to facilitate comparison with publications by other financial institutions. References have been made to 'Bank' rather than 'Group' in the definitions relating to banking operations provided below as this is the operating level of the Group.

Basel	The Basel Committee on Banking Supervision's statement of best practice that defines the methods by which firms should calculate their Regulatory Capital Requirements to retain sufficient capital to protect the financial system against unexpected losses. Enacted in the EU through the capital requirements directives.
Basis Points (bps)	One hundredth of one percent (0.01%), so 100 Basis Points is 1%. Used in quoting movements in interest rates or yields on securities.
Capital Requirements	Capital required under Pillar 1. Capital requirements are 8% of Risk Weighted Assets (of which 4.5% must be Common Equity Tier 1 Capital).
Capital Requirements Directive (CRD)	European legislation giving force to the Basel regulatory capital framework in the UK. The latest legislation is commonly referred to as CRD IV came into effect from 1 January 2014 and comprises the Capital Requirements Regulation (CRR) and the Capital Requirements Directive (CRD).
Common Equity Tier 1 (CET1) Capital	The highest quality regulatory capital resources, comprising retained earnings less regulatory adjustments as defined under CRD IV.
Common Equity Tier 1 Capital Ratio	The ratio of Common Equity Tier 1 Capital to Risk Weighted Assets.
Credit Risk	The risk of financial loss arising from a failure of a customer or counterparty to settle their financial and contractual obligations as they fall due.
Credit Value Adjustment (CVA)	Adjustments to the fair values of derivative assets to reflect the creditworthiness of the counterparty.
Colleague engagement	Engagement level for employees is measured based on responses to questions covering five areas. This is a measure of colleague sentiment based on their advocacy, confidence, commitment, pride and their willingness to give discretionary effort that supports productivity and performance.
Customer Net Interest Margin (NIM)	Total net interest income divided by average customer assets for the period.
Derivative	A financial instrument that has a value based on the expected future price movements of the instrument or index to which it is linked, such as a share or a currency.
Effective Interest Rate (EIR)	The EIR is the rate that exactly discounts estimated cash flows (excluding credit losses) to zero through the expected life of the financial instrument. It is used to calculate the amortised cost of financial instruments and to recognise interest receivable or payable over its expected life.
European Banking Authority (EBA)	European Banking Authority is a European organisation whose main task is to contribute, through the adoption of Binding Technical Standards (BTS) and Guidelines, to the creation of the European Single Rulebook in banking. The Single Rulebook aims at providing a single set of harmonised prudential rules for financial institutions throughout the EU, helping create a level playing field and providing high protection to depositors, investors and consumers.
Expected credit loss (ECL)	The weighted average credit losses, with the probability of default (PD) as the weight.
Exposure at Default (EAD)	The amount expected to be owed at the time of default.
Fair Value Through P&L (FVTPL)	The classification of instruments that are held for trading or for which the business model is to manage the financial asset on a fair value basis i.e. to realise the asset through sales as opposed to holding the asset to collect contractual cash flows. This category applies if the requirements to be classified as amortised cost or FVOCI are not met. Equity instruments are normally measured at FVTPL. All derivatives would be classified as at FVTPL.
Fair Value Through Other Comprehensive Income (FVOCI)	The classification for instruments for which there is a dual business model i.e. the business model is achieved by both holding the financial asset to collect the contractual cash flows and through the sale of the financial assets. The characteristics of the contractual cash flows of instruments in this category must be solely payments of principal and interest. On initial recognition, an irrevocable election (on an instrument-by-instrument basis) may be made to designate an equity instrument at FVOCI. This option only applies to instruments that are not held for trading and are not derivatives.
Financial Conduct Authority (FCA)	The UK conduct regulator which is responsible for the regulation of conduct in retail, as well as wholesale, financial markets and the infrastructure that supports those markets. The FCA's objective is to protect consumers, promote competition and enhance market integrity.
Internal Liquidity Adequacy Assessment Process (ILAAP)	The internal assessment of the levels of liquidity that need to be held to meet regulatory liquidity requirements.
Internal Capital Adequacy Assessment Process	The internal assessment of the levels of capital that need to be held to meet regulatory capital requirements.
Liquidity Coverage Ratio (LCR)	A liquidity metric which aims to ensure that a firm maintains an adequate level of liquidity to meet its needs for a 30 calendar day time horizon under a severe stress scenario.
Loss Given Default (LGD)	The expectation of the extent of loss on a defaulted exposure.

LTV	A ratio which expresses the amount of a mortgage as a percentage of the value of the property. The Bank calculates residential mortgage LTV on an indexed basis (the value of the property is updated on a quarterly basis to reflect changes in the house price index (HPI).
Medium-term Notes (MTN)	Corporate notes continuously offered by a company to investors through a dealer. Investors can choose between differing maturities ranging from 9 months to 30 years.
Net Interest Income	The difference between the interest received on assets and interest paid on liabilities (customer deposits).
Operating cost:income ratio	Operating cost:income ratio is calculated as operating costs (staff and non-staff) and continuous improvement project expenditure divided by operating income excluding losses on asset sales.
Positive mortgage net lending	Mortgage completions less mortgage redemptions and capital repayments.
Prudential Regulation Authority (PRA)	The UK prudential regulator which is part of the Bank of England and alongside the FCA has responsibility for the oversight of relevant financial institutions. The PRA's objective is to promote the safety and soundness of regulated firms.
Probability of Default (PD)	The likelihood of a borrower defaulting either on a 12 month PD for stage 1 assets or on a lifetime PD for stage 2 and 3 assets.
Purchased or Originated Credit Impaired (POCI)	Purchased or originated financial assets that are credit-impaired on initial recognition.
PV01	Measures the sensitivity of the Net Present Value (NPV) to a one basis point (bp) parallel shift in interest rates.
Risk Appetite	The level of risk that the Group or Bank is willing to take (or not take) in order to safeguard the interests of stakeholders whilst achieving its business objectives.
Risk Weighted Assets	A regulatory measure that adjusts the value of assets to reflect their level of risk when calculating capital requirements – RWAs are required to be calculated for the Bank to provide for three types of risk: (i) Credit risk; (ii) Market risk; and (iii) Operational risk. The Bank considers market risk within credit risk. The Bank's capital ratios are calculated from the sum of the three RWA categories.
Sectionalisation	A sectionalised pension fund is a scheme that contains two or more 'sections' that are formally separate for funding and benefit purposes.
Securitisation	A process by which a group of assets are aggregated into a pool which is used to back the issuance of debt securities in issue. The assets are transferred to a special purpose vehicle which then issues the securities backed by the assets. Securitisation vehicles are established by the Group and the Bank as part of its funding and capital management activities.
Small and Medium-sized Entities (SME)	Small and medium sized businesses engaging with the bank as customers.
Sterling Overnight Interbank Average (SONIA)	Sterling Over Night Interbank Average (SONIA). Yield curves used by the Bank for swap arrangements. These are based on overnight indexed rates.
Stress testing	Assessing the risk of a portfolio using a "what if" approach to represent various economic changes, for example, a rise in unemployment.
Term deposit	A deposit balance that cannot be withdrawn before a date specified (without penalty) at the time of deposit.
Term Funding Scheme (TFS)	A scheme launched by the Bank of England designed to grow lending to households and businesses by providing term funding to participating banks and building societies at rates close to the Bank Rate.
Tier 1 Capital	The total of Common Equity Tier 1 and Additional Tier 1 Capital (note that the Group does not currently hold Additional Tier 1 Capital).
Total Capital	The total capital resources less regulatory adjustments.
Unfunded pension scheme	Pension scheme which has liabilities and no assets. The Bank will pay the liabilities of the scheme as they fall due.
Watchlist	A list of counterparties drawn up by the Bank once it has elected to closely monitor the performance of loans subject to significant credit risk.
Wholesale funding	The funding that is available between banks and other financial or commercial institutions. Examples of wholesale funding include covered bonds, deposits and government guarantees.
Issuer Company	In order for the Bank to issue MREL qualifying debt instruments, in February 2019 a new company was incorporated as an intermediary company between Bank Company and Holding Company. This entity is called The Co-operative Bank Finance Limited ('Issuer Company') and will be a fully owned subsidiary of Holding Company. In turn, Bank Company will be a fully owned subsidiary of Issuer Company.

The summary below defines the KPI metrics used within the Annual Report and Accounts:

Financial Performance KPIs

	Definition	Why it is important to the business and management
Group profit or (loss) before tax	This represents total profit/(loss) once all income and expenses are taken into account excluding tax, at the Group consolidated level.	This is a primary profitability measure used by management to assess performance.
Group adjusted profit or (loss) before tax	This represents the Group's profit/(loss). For 2017 this excludes the £356.3m income statement gain generated as a result of the 2017 Restructuring and Recapitalisation.	This is a primary profitability measure used by management to assess performance.
Bank profit or (loss) before tax	This represents all income and expenses except taxation.	This is a primary profitability measure used by management to assess performance.
Customer net interest margin	Total net interest income divided by average customer assets for the period.	The net interest margin is the key measure of the ability to generate revenue.
Operating cost:income ratio	Operating cost:income ratio is calculated as operating costs (staff and non-staff) and continuous improvement project expenditure divided by operating income excluding losses on asset sales.	A principal measure of the efficiency of overall operations.

Capital and liquidity KPIs

	Definition	Why it is important for the business and management
CET1 ratio	Common Equity Tier 1 (CET1) is equivalent to tangible shareholders' funds less certain capital deductions. Calculated as CET1 resources expressed as a percentage of Risk Weighted Assets (RWAs).	There is a requirement to maintain minimum regulatory capital and capital ratios at all times. As there are currently only CET1 resources, the minimum Pillar 1 capital requirements i.e. 8% of RWAs are met entirely with CET1 resources.
Total Capital Ratio (TCR)	The ratio of total capital resources to total RWAs.	There is a requirement to maintain minimum regulatory capital and capital ratios at all times. The total capital ratio is important in order to withstand any future market-wide or individual stresses.
Leverage Ratio	A ratio calculated by dividing Total Tier 1 capital (after deductions) by adjusted balance sheet exposure.	Under the UK leverage ratio framework, a minimum leverage ratio requirement applies to firms with retail deposits greater than or equal to £50bn. Whilst this minimum leverage ratio requirement doesn't currently apply, the leverage ratio continues to be assessed against the broader UK requirement.
Risk Weighted Assets (RWAs)	RWAs are required to be calculated to provide for three types of risk: i) Credit risk, ii) Market risk (included in credit risk); and iii) Operational risk.	Capital ratios are a measure of risk calculated from the sum of the three RWA categories.
Liquidity Coverage Ratio (LCR)	LCR is the primary regulatory standard for liquidity and Individual Liquidity Guidance is set with reference to LCR. UK banks are required to maintain a minimum of 100% of LCR, from 2018.	Represents a surplus to regulatory requirements. A strong liquidity position aligns to the risk strategy to maintain a prudent liquidity position, although the surplus to regulatory requirements may vary due to cash flow mismatches and fluctuations in the funding profile over time.

Franchise KPIs

The KPIs below are measured at Group level but are applicable to the Bank.

	Definition	Why it is important to the business and management
Customer assets	The outstanding amount of money lent to customers.	The interest received on loans is the primary source of revenue. The amount and quality of assets is considered against risk appetite and their capital requirements.
Mortgage completions	The value of new mortgage applications completed within the year.	Mortgages are the primary type of lending and new business needs to be continually written to replace mortgages that redeem. This is a key objective of the Financial Plan.
Mortgage redemptions	The value of the mortgages that have been redeemed during the year.	Minimising redemptions in order to generate net asset growth is included within the Financial Plan.
Customer deposits	The amount of money customers hold in their accounts, also known as customer liabilities.	Customer deposits are a key source of funding to support customer assets. To manage the overall interest expense, these deposits are optimised versus other sources of liquidity.
Total current account holders	The total number of open current accounts.	Current accounts are a key product.
Prime current account holders	Customers holding an account who on average pay in £800 or more per month.	A measure of the size and quality of active current account customer base.
Net Promoter Score (NPS)	A measure showing how likely a customer is to recommend The Co-operative Bank as a current account provider.	NPS is a good indicator of business and growth as it is a measure of customer advocacy/loyalty and an indication of the level of customer service being delivered.