The Co-operative Bank plc
Annual Report and Accounts
2014

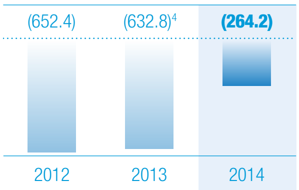
Contents

Key Performance Indicators

The Key Performance Indicators presented below[1] reflect the way in which the performance of the Bank was measured in 2014. As it implements its turnaround, management will continue to review these measures.

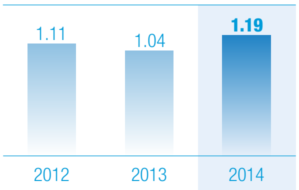
Total Bank

Statutory profit (loss) before tax[3] (£m)



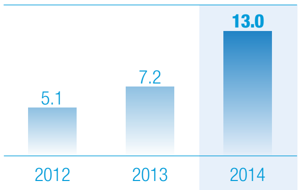
The reduced statutory loss before tax is driven by credit impairment write backs and reduced conduct and legal charges.

Net Interest Margin[2] (%)



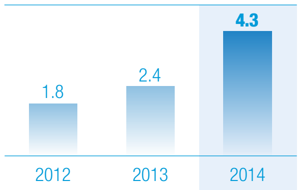
The modest increase in Net Interest Margin reflects reduced deposit and wholesale funding costs despite lower customer balances.

Common Equity Tier 1 (CET1) Ratio[3] (%)



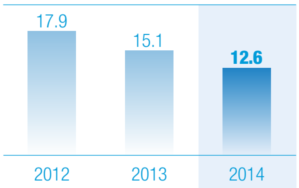
The significant improvement in CET1 reflects the £400m capital raising, £313m Co-operative Group capital contribution, continued successful Non-core deleverage and also lower Core customer balances.

Leverage ratio[1] (%)



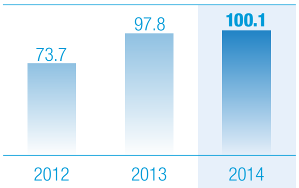
Significant improvement reflects £400m capital raising, £313m Co-operative Group capital contribution and decreases in balance sheet exposures.

Total RWAs[3] (£bn)



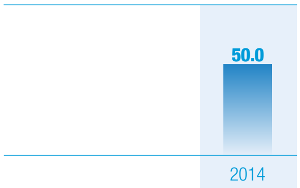
Total RWAs have reduced in line with Non-core deleverage and reduction in Core customer balances.

Cost Income Ratio[3] (%)



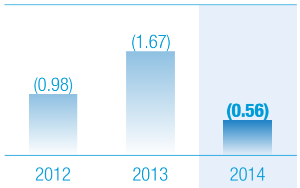
The increase in cost income ratio reflect a reduced income from lower customer balances than anticipated and remediation costs.

Staff Engagement (%)



The Bank measures the engagement level of its employees based on responses to five questions. For 2014 the employee engagement index was 50%. A direct comparison to previous years cannot be made.

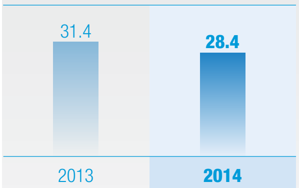
Return on Assets[3] (%)



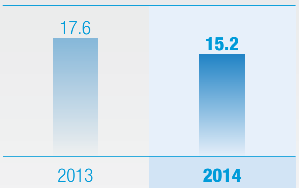
The Bank's return on assets has been negative for the previous three years due to losses in the Bank.

Core Bank

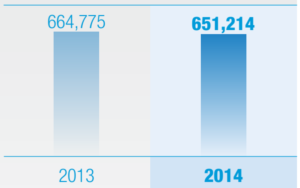
Customer Deposits[5] (£bn)



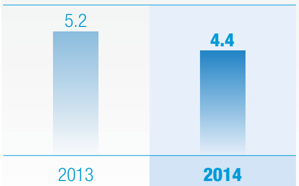
Customer Assets[5] (£bn)



Primary Current Account Holders

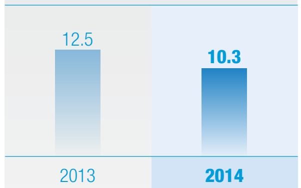


Credit RWAs[3] (£bn)

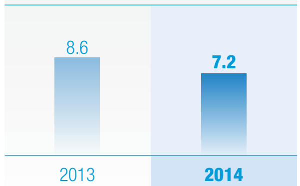


Non-core Bank

Customer Assets[3] (£bn)



Credit RWAs[3] (£bn)



Please see 'Key Performance Indicators' on page 23 for explanations of why these metrics are important and how they are calculated.

1. KPIs are calculated on a management accounts basis as this is how we manage our business.
2. Excludes provision for customer redress.
3. 2012 and 2013 figures have been restated, please see note 3 of the accounts for details.
4. 2013 statutory loss is net of LME gain of £688.3m.
5. This excludes Unity Trust Bank.

Bank performance

Key highlights and outlook

Over 2014 the management team has continued to take significant steps in implementing the Bank's strategy and towards turning the Bank around

- The Bank's year end CET1 ratio stood at 13.0%. This follows the £400m capital raising in May 2014, the final £313m capital contribution from The Co-operative Group, the write back of credit impairment provisions on Non-core assets and the speed and timing of the deleverage of those assets.
- Good levels of liquidity were maintained during 2014.
- Bank continued to exceed its target for reductions in Non-core assets, from £12.5bn to £10.3bn at year end resulting in a corresponding reduction of £1.4bn of Risk Weighted Assets (RWAs).
- Progress made on improving day-to-day management, in beginning to embed cultural change across the organisation and in improving governance.
- Begun to reinvest in the Bank's brand, starting with an advertising campaign focused on the Bank's values and ethics, and the new Ethical Policy was announced in January 2015.

Statutory losses before taxation of £264.2m, considerably better than 2013 but the issues that came to light during 2013 continue to dominate the financial performance of the business

- Compares to a loss before taxation of £632.8m in 2013 driven by significant reductions in the level of credit and conduct related charges.
- Total conduct and legal related charges, including PPI, are down from £411.5m in 2013 to £101.2m in 2014 and predominantly comprise of £69.0m relating to previously identified breaches of the technical provisions of CCA and includes a provision of £17.4m separately provided for packaged accounts.
- The reduction in underlying costs has been offset by the need to increase specialist and temporary resource in the short to medium term to support the Bank's transformation and the necessary remediation of systems and processes.
- As a result of active management the net interest margin has increased year on year by 0.15% to 1.19% largely driven by the reduced cost of deposits.

As announced at time of Bank of England stress tests, a revised plan[1] has been accepted by the regulator and runs until 2019

- Only material change from previously announced strategy is the planned significant acceleration of the reduction in Risk Weighted Assets (RWAs), primarily through reducing the Optimum portfolio, a closed book of residential mortgages, which is particularly susceptible to a severe economic stress.
- Whilst the Bank was temporarily compliant with Individual Capital Guidance (ICG) at the year end, as we have outlined previously, we only anticipate meeting ICG on a sustainable basis by the latter part of the planning period.
- Sale of Optimum has revenue implications which require further reduction in the Bank's cost base if the Bank is to achieve its longer term cost income ratio of below 60%.
- Total Bank RWAs are now targeted to fall below £7.5bn by end of 2018.

Simplifying of the business and reducing underlying costs continues as we reshape

- Direct Retail costs reduced by 10.2% over 2014 against 2013.
- Size of branch network reduced by 72 branches in 2014 and a programme to close a further 57 branches later this year announced.
- Year end FTE numbers reduced from 6,704 in 2013 to 5,711.

Performance of the Core Bank stabilised in the second half of the year as we were able to begin reinvesting in the brand

- Total number of current accounts decreased by 4% during 2014.
- Primary current accounts improved in the second half of the year although there remains considerable work ahead to re-establish the Bank's market position.
- Competitive positioning in second half of the year led to an improved year for new intermediary mortgage sales and the mortgage pipeline is improved when compared with the early part of 2014.
- Mortgage balances reduced as a greater number of mortgages came to the end of their natural term or switched to a competitor.
- Significant investment and progress has been made in improving our digital offering and the Bank's new mobile app launched in March 2014 now has more than 275,000 active users.

Values and ethics remain at the heart of the business as expanded Ethical Policy launched

- Over 74,000 customers and colleagues participated in the Ethical Poll in June.
- Bank recommits to all its existing policy statements around the businesses and organisations it will and won't lend to.
- Expanded Ethical Policy announced in January 2015 also covers the products and services offered to customers, the Bank's relationships with external stakeholders and suppliers and the workplace and culture in the Bank.

Focus for 2015 continues to be on de-risking the Bank and on making it more resilient

- Continued reduction of RWAs primarily through reducing the Optimum portfolio.
- Migration of the management of the IT infrastructure from The Co-operative Group to IBM which will, when delivered, improve the resilience of the Bank's IT infrastructure.
- Continued investment in the brand and development of products and services which reflect the expanded Ethical Policy including the launch of a new overdraft proposition.
- Further improvement in margins, processes, cost control and asset generation in the retail business.
- Risk Management Framework continues to be embedded.

1. See page 26 for more information.

Strategic report

Strategic report

The Directors present their Strategic report for the Bank for the year ended 31 December 2014 as required by the Companies Act 2006. During 2013 the UK Government issued a new requirement for all companies to produce a Strategic report, with specific requirements for quoted companies with listed ordinary shares. Although the Bank's ordinary shares are not listed, the Bank has adopted these requirements which include a review of strategy and business model and the principal risks and uncertainties of the Bank. The Strategic report includes the following:

This Strategic report for the Bank has been drawn up and presented in accordance with, and in reliance upon, the Companies Act 2006. The liabilities of Directors in connection with this report shall be subject to the limitations and restrictions provided by such law.

Approved by the Board of Directors and signed on behalf of the Board.

Dennis Holt
Chairman
26 March 2015

Chairman's statement

"We remain in the early stages of our turnaround and are well aware that much further work is required before the task is completed."

The Co-operative Bank has made significant progress since the depths of its crisis in 2013, driven by a renewed management team under the leadership of Niall Booker, and a revitalised Board of Directors led until October 2014 by my predecessor, Richard Pym. The Board and I would like to thank Richard again for his vital contribution which helped deliver stability and improved overall governance. Immediate priorities were to improve capital strength, to preserve prudent levels of liquidity and to surface the scale of risk within the portfolio, particularly in terms of asset quality, IT and conduct risk. This was essential before the Bank could sustain the journey to regain the confidence of our customers and to build a profitable Bank that will meet the expectations of all of our stakeholders – customers, colleagues, regulators and investors. Risks remain, there is still a considerable task ahead to turn the Bank around but we are making good progress against our strategic plan. The Bank's regulators (Financial Conduct Authority (FCA), and Prudential Regulation Authority (PRA)) understand the current situation of the Bank and have accepted the revised plan[1].

Following the successful completion of the Liability Management Exercise in December 2013, we began implementing our plan focused on strengthening the resilience of the Bank and reshaping the organisation around its individual and small and medium sized business customers. During 2014 the Bank's capital position continued to improve following the additional £400m capital raising in May and the final £313m contribution from The Co-operative Group. Our Core Capital CET1 ratio was 13.0% at the end of 2014 and whilst we do not yet meet the Bank of England's stress test scenario of extreme economic circumstances, a clear plan is in place to achieve this. This revised plan, which has been accepted by the PRA, is based on the Bank accelerating its strategy to significantly reduce Risk Weighted Assets. The Bank's management has demonstrated a strong track record on this to date. Although the Bank temporarily met Individual Capital Guidance (ICG) at the end of the year, this plan will see the Bank meet ICG on a sustainable basis towards the end of the plan. Liquidity has improved at the end of 2014 and new provisions for bad debts and conduct risks are materially lower than at the end of 2013.

1. For more information see page 26.

Our focus now is to build on this progress. We are making headway in deleveraging Non-core assets at acceptable pricing levels, and we are currently ahead of schedule. We have begun repositioning the Core Bank in terms of products and distribution, and the Bank has seen an improvement in its service and satisfaction measures over the course of 2014. Our initial reinvestment in the brand in October will continue through 2015 as will the journey towards a more modern, digitally led Bank as we respond to the changing trends in how customers want to bank. In terms of IT and Operations, we have clear plans in place to address past underinvestment and to provide robust and cost effective standards. We are also supporting our colleagues through this period of major change whilst building skills and supporting a customer focused culture.

Over 2014 governance standards have been enhanced, and the Bank has made material progress against the issues outlined in Sir Christopher Kelly's independent report, published in April 2014. Improvement of our risk management processes and practices remains a critical priority and we have overhauled the structure and begun to embed it. Management strength is being rebuilt and we are well advanced in assembling a Board with the quality and experience to effectively oversee our transformation programme. Although The Co-operative Group remains our largest single shareholder and we remain united by our brand and our values, we also continue to progress the necessary separation of our systems and processes as part of transforming the business.

We remain in the early stages of our turnaround and are well aware that much further work is required to reduce risk and build resilience in the business before the task is completed. However, we now have a clear vision of a sustainable Bank with a distinctive customer proposition rooted in our Values and Ethics. These are as much a part of our future as our history. There remains much to be done to rebuild The Co-operative Bank as a viable alternative to the traditional banks but we are encouraged on that journey by the loyalty of our customers; the determination of our staff to restore the good name of The Co-operative Bank; and the commitment and support of our investors.

Dennis Holt
Chairman
26 March 2015

Our two business areas:
Core and Non-core

As part of the Bank's plan to simplify, build resilience, de-risk and reshape its business and to address the underlying issues which it faces, the Core and Non-core business areas are managed as set out below:

	Core Business	Non-core Business (Co-operative Asset Management)
Definition	• Consistent with the Bank's strategy and risk appetite **Includes:** • Retail banking (Retail) – which trades as The Co-operative Bank, Britannia and **smile**, together with the Bank's intermediary mortgage brand, Platform, and includes Retail secured and unsecured lending • Business and Commercial Banking (BaCB) – which services small and medium sized businesses (SMEs) which will typically (i) have a turnover of less than £25m; (ii) have borrowing requirements of less than £10m; and (iii) otherwise meet the Bank's risk appetite (including charities, social businesses and co-operatives) • Treasury • Unity Trust Bank[1]	• Inconsistent with the Core Business strategy and risk appetite • Cannot be supported by Core Business' Retail platform • Non-core assets are typically non-performing, defaulted, unprofitable and/or capital intensive products **Includes:** • Corporates – which typically have a turnover of over £25m or otherwise do not meet the Bank's risk appetite • Commercial Real Estate • Project Finance • Housing Associations • Local Authorities • Large scale Renewable Energy and Asset Finance[2] • Optimum (a closed book of predominantly interest-only, intermediary and acquired mortgage book assets)
Focus	• Retail and SME customers • Values and ethics that both underpin our business and distinguish us in the marketplace • Relationship-based banking • Where we have strong market credentials, relationships and expertise	• Managing these businesses to achieve deleverage that does not materially reduce the CET1 ratio of the Bank as a whole; or • Targeting an accelerated RWA reduction to reduce the Bank's total RWAs below £7.5bn by the end of 2018
Customer Assets/Credit RWAs	**£15.2bn/£4.4bn**	**£10.3bn/£7.2bn**

1. Unity Trust Bank operates in the social economy and commercial banking sectors and is consolidated into the Bank's results on the basis of control. On 14 January 2014, it was announced that the Bank is in discussions with the Board of Unity Trust Bank about a potential sale of its 26.7% shareholding. Discussions are in progress and any decision on a changed ownership structure would be subject to regulatory approval.
2. The sale of an element of the book was agreed prior to year end and will complete in 2015, subject to borrower consent.

Our strategy

The Bank's focus is implementing its strategy of becoming, over the next four to five years, a smaller and efficient bank underpinned by its Ethical Policy which covers all products and services offered to customers, the Bank's relationships with external stakeholders and suppliers and the workplace culture and ways of working for colleagues in the Bank.

Overarching strategy

Leverage brand strength and high levels of customer satisfaction

Reduce overall risk profile
Liquidity, capital and resilience of its day-to-day business

Reduce Risk Weighted Assets
Minimise impact on capital

Act in accordance with Co-operative values and ethics
doing the right thing by our customers

Core business strategy

Simplify and focus on Retail and SMEs

Enhance returns

Non-core business strategy

Actively manage to achieve the most appropriate value for each portfolio or target for run down or exit

Taking into consideration liquidity and capital requirements

Key actions for the Core business

Key actions for the Non-core business

- Establish an effective and efficient operational and governance structure
- Manage reputational and conduct risk
- Data remediation
- Continue to improve capital strength

Core business:

- Improved internet and mobile banking functionality leading to increased self-service
- Re-engineering of IT platform
- Business process simplification
- Streamline Retail and SME product offering
- Deepen customer relationships
- Re-price to market/exit uneconomic products
- Redesign of products in line with ethics and values

Non-core business:

- Active management of assets
- Optimum deleverage
- Single asset and portfolio sales
- Optimisation of borrowers' funding structures
- Re-banking of Non-core customers
- Run down closed businesses over the longer term

Efficient and profitable UK bank retaining its Co-operative values focused on Retail and SMEs

The Bank's revised plan, which runs from 2015-2019, accepted by the PRA, does not change the above strategy. It looks to accelerate the deleveraging of the Non-core business, significantly improving the Bank's resilience to a stress test as severe as the one run by the Bank of England in 2014 towards the end of the plan

Business model

Core

As at 31 December 2014, the Core Bank had 4.4m customers, of which 4.3m were Retail and 0.1m were SME customers, and operated through a network of 222 branches, 17 business banking centres and three primary call centres, 1,911 ATMs[1], the internet and digital channels.

Non-core

Managing these businesses to achieve the most appropriate asset value or targeting run-down or exit.

How we make money

Business activity	Balance sheet impact	Income statement impact	Principal risks
We lend money to customers	Loans create assets in our balance sheet that will generate future income	We earn interest income and may incur credit impairment charges	• Credit risk • Market risk • Operational risk • Liquidity and funding risk • Conduct risk
We accept deposits from customers	Deposits are a source of funding for the Bank (liabilities) which often incur interest expense	We may pay interest on deposits	• Liquidity and funding risk • Market risk • Operational risk • Conduct risk
We source funding from other banks and the capital markets	Wholesale funding is a liability for the Bank on which we incur interest expense	We pay interest on wholesale funding	• Liquidity and funding risk • Market risk • Operational risk
We provide transactional banking facilities	Not significant	We earn net fee and commission revenue	• Operational risk • Conduct risk
We invest in people in order to execute our strategy and deliver service to our customers	Minimal	Staff costs	• Operational risk • Conduct risk • People risk • Pension risk
We invest in our operations (IT and infrastructure) to deliver service to our customers while managing costs	Property, plant and equipment and intangible assets	Transformation project costs and cost savings	• Operational risk • Strategic and business risk

1. 1,712 of the ATMs are scheduled to be sold in 2015 which would result in 199 ATMs remaining within the Bank.

Chief Executive's review

Overarching strategy

The Co-operative Bank's overarching strategy to turn the business around is to leverage our historic brand strength and high levels of customer service satisfaction to create, over time, an efficient and profitable bank with a reduced overall risk profile.

This requires us to simplify and focus the Core business on Retail banking and small and medium sized business customers where we feel we have strong existing market credentials, customer relationships and expertise, whilst achieving significant operational efficiencies.

Those assets which are not consistent with our strategy and classified as part of the Non-core business will be actively managed to achieve the most appropriate asset value on an individual or portfolio basis or targeted for run down or exit. The need to invest in our IT platform and to increase resilience is an essential prerequisite to building a sustainable business.

The essence of our customer proposition is to deliver easy to understand, fair and transparently priced products that are easy to use. This will require us over time to improve our products, processes, digital offering and culture.

The Bank's revised plan, which runs from 2015–2019, accepted by the PRA, does not change the strategy. It looks to accelerate the deleveraging of the Non-core business, significantly improving, over the life of the plan, the Bank's resilience to a stress test as severe as the one run by the Bank of England in 2014.

"Over the course of 2014 the management team has continued to take significant steps to implement our strategy and to turn the Bank around. Our results reflect the progress we have made to date as we simplify and reshape the business to focus on our personal and small and medium sized business customers. The Co-operative Bank is stronger than a year ago but we are in the early stages of the turnaround and there is still much to do to transform the Bank into a sustainable business."

As we announced at the time of the Bank of England stress tests in December 2014, we now have a revised plan, accepted by the regulator, and designed to withstand a severe economic stress towards the end of the plan. The only material change from our previously announced strategy is the significant acceleration of the reduction in Risk Weighted Assets (RWA), primarily through reducing the Optimum portfolio, a closed book of residential mortgages, which is particularly susceptible to a severe economic stress. This will reduce our capital requirements over the longer term. We are progressing the reduction whilst current market conditions remain favourable. The Bank's regulators, FCA and PRA, understand the current situation of the Bank and have accepted the revised plan[1].

In the first year of implementing our plan, we focused on building capital and liquidity and the run down of our Non-core assets. At the end of 2014 our CET1 ratio stood at 13.0% (compared to 7.2% (restated) at the end of 2013), and I am pleased to report that we exceeded our target for reductions in Non-core assets. Our liquidity is also strong. However, in the short to medium term, based on the level of investment required and the continued unwind of our Fair Value Adjustments (FVAs) we expect to continue to be loss making for at least two years and therefore our CET1 ratio is expected to reduce before it improves again. Whilst the Bank is compliant with Individual Capital Guidance (ICG) at the end of 2014 as we have outlined previously, we only anticipate meeting ICG on a sustainable basis by the latter part of the planning period.

As we move into the second year of the turnaround, our focus continues to be on derisking the Bank and on making it more resilient. As part of this focus we are simplifying the business, reducing costs and strengthening the culture of the organisation. This is all with the aim of building a sustainable Core Bank differentiated by adherence to Co-operative principles and Values and Ethics.

1. For more information see page 26.

Chief Executive's review continued

We have made progress on improving day-to-day management, in beginning to embed cultural change across the organisation and in improving our governance. Although there is still considerable work ahead to simplify our product range and build the required resilience in the Bank, not least in the Bank's IT systems, we continue to make progress on embedding a revised risk management framework and in improving the Bank's controls. Our recent announcement to migrate the management of our IT infrastructure from The Co-operative Group to IBM will, when delivered, improve the resilience of our IT infrastructure and provide the foundation for the necessary transformation of our systems and the further development of our digital capability to better serve customers' future needs.

There is more to do in our retail business but over 2014 the majority of our customers have remained loyal and, as we drive down the underlying costs of the Core business, we continue our work to reshape the Bank as a more efficient and agile organisation. I am pleased that we have now begun to reinvest in our brand, which started with an advertising campaign that focused on our values and ethics, the factor that makes The Co-operative Bank different. We are also investing in our people and have begun the process of rolling out revised workplace values and ways of working, devised in conjunction with colleagues as we seek to combine pace, the ability to implement effectively and accountability whilst maintaining the service ethic and empathy for which we are well known. We have also started a process of talent identification and development and an important milestone for me personally was the relaunch of our graduate programme. These people related developments are critical to the future performance of the business but will take time to embed.

I would like to thank all our customers for their loyalty, our shareholders for their support and our colleagues for their continued hard work and dedication. The steps we are taking are building a stronger and better business for all our stakeholders. There is much more to do but I am confident that our approach to banking is as relevant in today's world as it ever was and that we can remain the bank of choice for anyone that shares the ethics and values that are at the heart of our business.

Financial Performance review

The financial performance of the business in 2014 remains dominated by the issues that came to light during 2013 including significant underinvestment in systems and processes. The statutory loss before taxation was £264.2m compared to a restated loss of £632.8m (after LME gain) in 2013. The main reasons for this change were significant reductions in the level of credit and conduct related charges. Credit impairments reduced from a statutory charge of £516.2m in 2013 to a release of £173.2m in 2014. The Bank continues to review products and practices, with total charges, including PPI, down from £411.5m in 2013 to £101.2m in 2014. This predominately comprises of £69.0m relating to previously identified breaches of the technical provisions of CCA, which are proving more complex than anticipated to address. It also includes a separate provision of £17.4m for packaged accounts. Prior year adjustments of £29.3m have affected the performance numbers, reflecting our ongoing drive to improve processes, procedures and accounting governance.

The Bank continues to be ahead of schedule in the disposal of Non-core assets with an overall reduction of these assets from £12.5bn at the beginning of the year to £10.3bn at year end. This has resulted in a corresponding reduction of £1.4bn of Risk Weighted Assets (RWAs) and contributed to an increased liquid asset ratio as well as the improved CET1 ratio.

At the end of 2014 the Bank's CET1 ratio stood at 13.0% up from 7.2% (restated) as at December 2013 and exceeding previous guidance. The improvement in our CET1 ratio was driven by the £400m of capital raised in May 2014, the final £313m capital contribution from The Co-operative Group under the terms of the 2013 Liability Management Exercise, the write back of credit impairment provisions on Non-core assets and the speed and timing of the deleverage of those assets.

Simplifying the business

The task of simplifying the business and reducing underlying costs remains a key focus for the Bank and during 2014, our cost reduction programme has continued to deliver savings. This has been driven specifically through the reduction in the size of the Branch network, by reducing the numbers of employees in head office and by starting to improve the efficiency of the Bank's processes.

As we have restructured the business and improved processes, overall permanent staff numbers have fallen, with full-time equivalents standing at 5,711 at the year end, a reduction of 993. The reduction in underlying costs has been offset by the need to increase specialist and temporary resource in the short to medium term to support the Bank's transformation and the necessary remediation of systems and processes.

Performance of Non-core

The dedicated team within Co-operative Asset Management (CoAM) has taken advantage of better than originally expected economic conditions in the UK during 2014 and their own restructuring skills to reduce Non-core customer assets by £1.2bn since the half year and by a total of £2.2bn during 2014.

Under our revised plan, the focus is now on the reduction of our Non-core residential mortgage portfolio (Optimum). Optimum was particularly vulnerable to the Bank of England hypothetical severe stress and consumes significant capital. By advancing the timing of its reduction, the Bank will significantly improve its resilience to a severe economic downturn. Market conditions remain positive and we are optimistic that a meaningful reduction can be achieved in the early part of the plan. It should however be noted that the sale of Optimum has revenue implications which require further reduction in our cost base if we are to achieve our cost income ratio of below 60% in the longer term. Total RWAs are now targeted to fall below £7.5bn by the end of 2018.

The sale of the Illius portfolio and the announced sale of the clean energy assets at the end of 2014 clearly illustrate the Bank's readiness and ability to execute these plans, but all sales do remain vulnerable to some level of market risk.

Performance of the Core Bank

The performance of the Core Bank stabilised in the second half of the year as the ongoing uncertainty around the Bank diminished and we were able to begin reinvesting in the brand and our products as well as engaging with customers on our values and ethics. In the first six months of the year the Bank continued to face uncertainty surrounding reviews into past failings, and there was the need to raise additional capital which was completed in May. These events created a sustained and negative news flow which impacted our ability to retain and attract customers in the face of increased competition in the current account market. In the second half of the year the net outflow of current accounts reduced significantly and we were able to start our fightback by beginning to reinvest in the brand. The response to the Bank's advertising campaign launched in October and centred on our ethical stance was positive in terms of awareness and recommendation.

Chief Executive's review continued

During 2014, the total number of current accounts decreased by 4% and the number of primary accounts, where the Bank provides the main banking service, also reduced by 2%, although the number increased marginally in the second half of the year. There remains considerable work ahead to re-establish the Bank's market share in a very competitive current account market and we are focused on developing our offering using the framework of our new Ethical Policy to guide us. The first step is the launch of a new overdraft proposition in 2015.

Our performance in mortgages was mixed. In the early part of the year, we were still recovering from our exit from the market in 2013 and were implementing the Mortgage Market Review. Throughout the second half of the year, after reviewing our processes, we became more competitive in the intermediary market, including launching the Bank's lowest ever two year fixed rate mortgage, and this has continued into early 2015. As a result 2014 was an improved year for new intermediary mortgage sales and at the beginning of 2015 the mortgage pipeline is significantly improved when compared with the early part of 2014. There is still more to do in our retail business in terms of margin improvement, process improvement, cost control and asset generation, as well as ensuring positive experiences and outcomes for our customers.

Significant investment and progress has been made in launching our digital offering and this investment and work will continue in 2015. Our new mobile app launched in March 2014 is evidence of this and now has more than 275,000 active users. Our improved internet banking service was launched in December and was rolled out to all customers in the first few weeks of 2015.

Having successfully protected our liquidity through the first half of the year, there has also been some managed reduction in high priced deposits during the second half. In light of the planned deleveraging of the Non-core book we will continue to proactively manage liquidity in 2015. As a result of active management the Bank net interest margin has increased year on year by 0.15% to 1.19% largely driven by the reduced cost of deposits.

Good progress has been made on addressing underlying cost in the Core Bank as we continue our work to reshape the Bank as a smaller and more agile organisation. Direct Retail costs reduced by 10.2% over 2014 against 2013, largely driven by reduced headcount of 993 and a reduced number of branches and facilities. We closed 72 branches during 2014 and have announced a programme to close a further 57 branches later this year. This will leave a network of 165 branches which is still larger than it was before the merger with Britannia. Our aim is to provide branches, where we know they are well-used, in parallel with our digital and telephone channels. We will continue to invest in our digital channel, reflecting customers' changing preferences for how they do their day-to-day banking. As the use of digital channels is likely to become more prevalent, we expect to close a small number of additional branches in future years.

Developing our offering for small businesses remains important to the Bank and we are investing in people to lead this, but given the breadth of other current priorities, the refreshing of this proposition remains in development.

Values and ethics

Our values and ethics have always been an important factor that both underpins our business and distinguishes us in the marketplace. Led by Laura Carstensen, the new Chair of the Values and Ethics Committee, we began the work to renew our Ethical Policy in 2014 and bring it into line with what our customers care about today.

Over 74,000 customers and colleagues told us in our Ethical Poll in June that they wanted us to recommit to all our existing policy statements around the businesses with particular reference to organisations we will and won't lend to. They also made it clear that the way the Bank is run should be more visibly reflected in the Policy in areas beyond lending. As a result the expanded Ethical Policy announced in January 2015 covers the products and services offered to customers, the Bank's relationships with external stakeholders and suppliers and the workplace, culture and ways of working for colleagues in the Bank. We are also committing to return to our campaigning heritage by using our voice to stand up for underserved causes that are in line with our values and ethics.

The launch of the Policy is just the beginning. Over the coming months we will be developing our plans in some of the new areas, including the products and services we offer our customers and each year we will be reporting back on the progress we are making. We are still the only high street bank with a customer-led ethical policy and we must now build on the commitments we have made and bring them to life in the products and services we provide our customers every day and in the way we run the Bank.

Outlook

The management team continues to focus on turning around the Bank, making it more resilient and implementing the revised plan accepted by the PRA in December. There is still plenty of work ahead to deliver the change required. Throughout 2014 the Bank has benefited from improvements in the macroeconomic environment and the domestic outlook at least for now remains relatively benign. During 2015, we will continue deleveraging Non-core assets to build our resilience to a severe economic stress under the revised plan. We will also continue to invest in The Co-operative Bank brand. We are currently developing our product offering to win new customers to the Bank, using our expanded Ethical Policy as our framework. Under the leadership of our new Chairman, Dennis Holt, who took over from Richard Pym on 27 October 2014, the progress to renew the Board continues.

As outlined in the interim statement, the Board established a committee to consider the feasibility and timing of an IPO. This has met on a couple of occasions to consider the options. Given that the business is still at an early stage of its recovery; and that the management team has a critical need to focus on implementing the revised plan, the Committee has concluded that the Bank is not in a position to undertake an IPO at this point in its journey but it will be an area that the Committee keeps under regular review.

Over 2014 we have taken some major steps forward but we have always been clear that the journey to reshape the business around our individual and small business customers would take time. Whilst the Bank is a Going Concern and stronger than it was, there remain fundamental issues to address in terms of improving resilience and bringing aspects of our business back within our risk appetite. However, alongside this work, the actions we have taken to strengthen the Bank now provide the platform to focus on what matters to our customers – restoring the brand, providing the products and services that best meet our customers' future needs and bringing to life the values and ethics that we share with them and that make us different. We continue to believe there is a market for a bank distinguished by its adherence to a customer led Ethical Policy and that there is value for all stakeholders in The Co-operative Bank fulfilling that need.

Niall Booker
Chief Executive Officer
26 March 2015

Summary financial review

Capital

- CET1 ratio at the end of the year is 13.0% (2013: 7.2% restated)
- Capital raising in May 2014 of £400m before costs, The Co-operative Group commitment of £313m received
- The above pushed the Bank marginally above ICG at the year end, however, will not sustainably meet ICG until later in the plan period

Liquidity

- Liquidity remains robust and above regulatory minima
- Total liquidity increased year on year by c. £1bn

Profitability

- Loss before tax of £264.2m (2013: £632.8m restated)
- Reduced loss driven by credit impairment writebacks of £173.2m (2013 charge: £516.2m) and reduced conduct and legal charges of £101.2m (2013: £411.5m) on a statutory basis
- 2013 loss included profit on LME of £688.3m

Detailed financial review

Capital

In plain English:

Capital is held by the Bank to protect its depositors and to cover the different risks faced by the Bank. The minimum amount of capital the Bank is required to hold is set by European and national regulators. The capital requirement is set with reference to the amount of risk the Bank takes, defined by the amount of RWAs the Bank holds for credit risk, market risk and operational risk. Credit risk represents 91% of Risk Weighted Assets (RWAs) which are calculated by weighting different types of loan according to the potential loss that might be incurred.

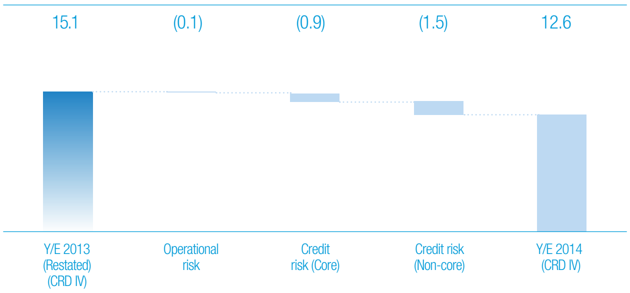
The amount of capital the Bank holds to meet requirements is specified in terms of the type of capital with specific requirements for CET1, the highest quality of capital, as well as total Tier 1 and total capital.

As at 31 December 2013 the Basel II capital framework applied to the Bank. The Basel III capital framework came into effect from 1 January 2014 and within the European Union this has to be implemented by a new Capital Requirements Directive (CRD IV). Under Basel III a Leverage Ratio has been introduced which is a simpler measure of Bank capital levels and is based on the amount of good quality capital (Tier 1) compared to the overall balance sheet of the Bank.

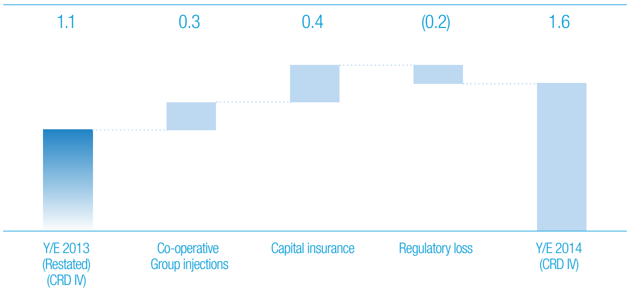
During 2014, the Bank has made progress toward improving the capital position and reducing the overall risk profile of the Bank. Completion of the £400m equity capital raising (£387m net of associated costs), together with the £313m of planned capital injections from The Co-operative Group[1] as well as ongoing deleveraging of RWAs, has resulted in a significant improvement in the capital position of the Bank.

All figures and graphs quoted below are reporting on a CRD IV fully loaded basis.

Risk Weighted Assets (£bn)

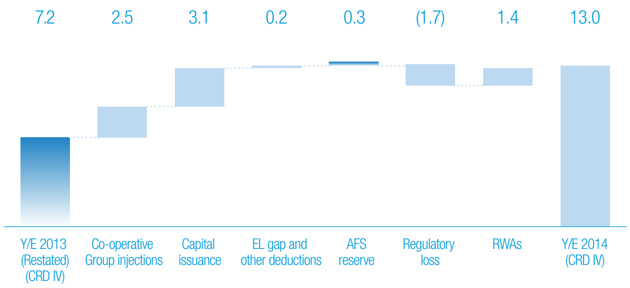


Common Equity Tier 1 (£bn)



1. The capital injections were made by The Co-operative Banking Group Limited, a wholly owned subsidiary of the Co-operative Group Limited.
2. For more information see page 26.

Common Equity Tier 1 ratio (%)



CRD IV fully loaded capital position

	As at 31 December 2014	Restated As at 31 December 2013	Change
Capital ratios			
CET1 ratio	**13.0%**	7.2%	5.8%
Total capital	**15.0%**	8.9%	6.1%
RWAs (£bn)	**12.6**	15.1	(2.5)
Leverage ratio	**4.3%**	2.4%	1.9%

The £400m equity capital raising and The Co-operative Group CET1 capital injections of £50m in January 2014, £100m in June 2014 and £163m in December 2014 were the primary factors in the Bank's CET1 position increasing by £0.5bn to £1.6bn. The increase in CET1 has resulted in the Bank's fully loaded CRD IV CET1 ratio increasing by 5.8%, from 7.2% to 13.0%.

RWAs have decreased by £2.5bn since last year end. Non-core assets have been deleveraged in line with strategy and this is reflected in the above £1.4bn reduction in Non-core RWAs. Leverage ratio is 4.3%, an increase of 1.9% since last year end, reflecting both capital injections and ongoing balance sheet deleveraging activity.

For most of 2014 the Bank was not compliant with its Individual Capital Guidance (ICG), being the PRA's guidance as to the regulatory capital (Pillar 2a) it expects the Bank to hold above Pillar 1, where Pillar 1 is the minimum required under the Capital Requirements Regulation. On 31 December 2014 the contribution from The Co-operative Group helped push the Bank into ICG compliance, however due to the Bank's ongoing losses, this position should be regarded as a temporary situation. The Bank met the Pillar I capital requirement throughout the year.

The revised plan[2], which has been accepted by the PRA anticipates that the Bank will meet the 7% CET1 ratio throughout the planning period and will sustainably meet ICG by the latter part of the planning period. The plan aims to build a sustainable Core Bank, and is designed to create a capital buffer by 2019 which would withstand a severe stress scenario equivalent to the 2014 Bank of England stress test.

Detailed financial review continued

Liquidity

Overview

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

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

- reduce retail fixed term deposits to match the reduction of balance sheet and reduce cost of liability base;
- reduce the holding of investment grade bonds that were not eligible to be included in the liquid asset buffer (LAB). It also reduced reliance on short dated secured financing to fund such assets and so in turn reduced the amount of Treasury assets encumbered by the Bank;
- substantially increase secondary liquidity by increasing the availability of mortgage collateral for funding;
- maintain ratings of secured funding programmes, by the implementation of rating agency compliant back-up servicing arrangements to ensure market access; and
- repay wholesale funding to the extent not required to support the Bank's liquidity position as conditions stabilise.

The Bank's deleveraging strategy will continue to reduce funding and liquidity requirements.

Credit rating

In April 2014, Moody's downgraded the Bank to Caa2 from Caa1. The current ratings are:

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

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

i. sub-investment grade ratings on the Bank's senior debt in turn leading to a significant reduction in the demand for these types of instrument;

ii. a negative impact on the Bank's ability to access short term unsecured wholesale funding; and

iii. heightened collateral requirements within some clearing systems.

In plain English:

A company's credit rating is an indication of a company's creditworthiness. The evaluation is made by a credit ratings agency. Some companies have internal rules which mean that they can only place money with a bank of a certain credit rating. When the Bank was downgraded therefore, some businesses were forced to move their money, others perceived increased risk (including individuals) and reduced their deposits with the Bank.

Liquidity portfolio

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

Primary liquidity has decreased over the period by £424.4m and secondary liquidity has increased by c. £1.4bn.

	2014 £m	2013 £m	Change £m
Operational balances with central banks	**4,487.4**	5,076.3	(588.9)
Gilts	**1,246.7**	789.5	457.2
Central government and multilateral development bank bonds	**819.5**	1,112.2	(292.7)
Total primary liquidity	**6,553.6**	6,978.0	(424.4)
Total secondary liquidity	**5,566.8**	4,215.4	1,351.4
Total liquidity	**12,120.4**	11,193.4	927.0

Retail and commercial funding

The majority of the Bank's funding comes from retail and commercial accounts. As at 31 December 2014, customer deposits were £29.8bn compared to £33.0bn as at 31 December 2013.

Retail deposits reduced over the period by £2.2bn. This forms part of the Bank's strategy to reduce its fixed term retail deposits to match the reduction in the balance sheet and to reduce the cost of liabilities.

The total amount of the Bank's corporate deposits reduced by almost £1bn over the year. This was due to the maturing of term deposits placed before last year's credit rating downgrades.

Detailed financial review continued

	2014 £m	2013 £m	Change £m
Current accounts			
Retail	**3,479.3**	3,378.1	101.2
Corporate	**2,346.1**	2,298.9	47.2
Total current accounts	**5,825.4**	5,677.0	148.4
Instant access savings accounts			
Retail	**7,936.9**	8,097.2	(160.3)
Corporate	**584.0**	666.2	(82.2)
Total instant access saving accounts	**8,520.9**	8,763.4	(242.5)
Term deposits and bonds			
Retail	**7,675.6**	9,879.5	(2,203.9)
Corporate	**431.6**	1,344.9	(913.3)
Total term deposits and bonds	**8,107.2**	11,224.4	(3,117.2)
Individual savings accounts (ISA)			
Retail – ISA Fixed	**3,557.4**	3,853.1	(295.7)
Retail – ISA Demand	**2,745.9**	2,455.2	290.7
Total ISA accounts	**6,303.3**	6,308.3	(5.0)
Other deposits	**1,121.0**	1,028.3	92.7
Total customer deposits	**29,877.8**	33,001.4	(3,123.6)

Wholesale funding

The Bank uses wholesale funding to supplement retail and corporate customer deposits by raising debt to diversify funding sources. The Bank has a variety of wholesale funding sources outstanding, including securitisations, covered bonds, unsecured notes, bilateral facilities, and repurchase agreements.

The Bank has repaid bilateral facilities and repo funding during the course of the year to reduce liquidity as conditions stablilised. The Bank optionally redeemed the Silk Road Finance Number Two securitisation in September 2014 of c. £466m. The Bank has given notice for the optional redemption of the Silk Road Finance Number One securitisation in March 2015 of c. £1.3bn.

	2014 £m	2013 £m	Change £m
Preference shares, PSBs and subordinated debt	**196.4**	196.3	0.1
Secured funding	**2,521.8**	4,339.5	(1,817.7)
Repos	**500.6**	2,119.3	(1,618.7)
Market borrowing	**46.0**	56.6	(10.6)
MTNs	**832.9**	884.0	(51.1)
Total wholesale funding	**4,097.7**	7,595.7	(3,498.0)

The table does not include the Funding for Lending Scheme (FLS). The Bank accessed the FLS in the first half of 2013, drawing £900m of UK treasury bills. The Bank repaid £350m of its FLS liability in 2014. The remaining UK treasury bills remain available to the Bank until March 2017.

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

The table below analyses contractual maturities (as opposed to internally expected repayment dates).

	2014 £m	2013 £m	Change £m
Repayable in less than 1 month	**84.8**	2,010.3	(1,925.5)
Repayable between 1 and 3 months	**324.1**	67.8	256.3
Repayable between 3 and 12 months	**389.8**	157.2	232.6
Repayable between 1 and 5 years	**580.8**	1,800.8	(1,220.0)
Repayable in more than 5 years	**2,718.2**	3,559.6	(841.4)
Total	**4,097.7**	7,595.7	(3,498.0)

Detailed financial review continued

Total Bank financial performance

The 2014 financial results reflect the progress made in implementing the strategy to turn the Bank around with a statutory loss before taxation of £264.2m representing a significant improvement on the 2013 loss (restated) of £632.8m. However, the Bank is in the early stages of its turnaround and substantial work remains to transform it into a sustainable business.

The primary drivers of 2014 performance are:

- an overall net impairment write back of £171.7m compared to a 2013 loss of £512.1m, largely as a result of improved economic conditions;
- material reduction in charges for conduct and legal risk provisions of £101.2m compared to a charge in 2013 of £411.5m;
- a reduction in operating expenditure of £61.3m to £594.6m reflecting management actions to address the costs base of the Bank primarily focused on the improvement and simplification of Bank processes in addition to third party and ATM estate savings and branch rationalisation; and
- the non-recurrence of prior year items relating to intangible asset impairment (£148.4m), operating gains as a result of the Liability Management Exercise (LME) (£688.3m) and net gain on sale of Treasury assets (£40.8m).

The Bank's net interest margin has improved by 15bps on prior year to 1.19% largely driven by the reduced cost of deposits.

The Bank exceeded its target to reduce Non-core assets. Customer assets of £10.3bn at the end of 2014 is ahead of the target of c. £11.0bn. This continued deleverage has been achieved via a combination of formal trade sales, proactive rebanking of the Bank's Corporate CoAM clients and the natural run off of the Non-core book.

The numbers referenced and presented on these pages are on a management accounts basis. A reconciliation of these numbers to the statutory accounts basis is provided in the segmental information in note 4. 2013 comparatives have been restated as described in note 3.

Bank performance

	2014 £m	Restated 2013 £m	Change £m
Net interest income	**480.4**	483.4	(3.0)
Gains/(losses) on asset sales	**(14.4)**	40.8	(55.2)
Non-interest income	**128.1**	146.5	(18.4)
Operating income	**594.1**	670.7	(76.6)
Operating expenditure	**(594.6)**	(655.9)	61.3
Project costs	**(226.5)**	(164.7)	(61.8)
Impairment gains/(losses) on loans and advances	**171.7**	(512.1)	683.8
Operating result	**(55.3)**	(662.0)	606.7
FSCS levy	**(24.4)**	(24.1)	(0.3)
Share of post tax profits/(losses) from joint ventures	**0.6**	0.7	(0.1)
Intangible asset impairment	**–**	(148.4)	148.4
Conduct/legal risk	**(101.2)**	(411.5)	310.3
LME	**–**	688.3	(688.3)
Fair value amortisation	**(83.9)**	(75.8)	(8.1)
Loss before taxation	**(264.2)**	(632.8)	368.6
Net interest margin	**1.19%**	1.04%	0.15%
Cost income ratio[1]	**100.1%**	97.8%	2.3%

1. Operating expenditure divided by operating income.

Charges in respect of the Financial Services Compensation Scheme (FSCS) levy are in line with prior year (restated) at £24.4m (2013: £24.1m restated). The unwind of the fair value adjustments associated with the merger of The Co-operative Bank and Britannia Building Society continues to impact the income statement with a charge of £83.9m incurred in the year (2013: £75.8m). Further information is included in note 40.

Operating expenditure

	2014 £m	2013 £m	Change £m
Core direct costs	**(199.5)**	(222.0)	22.5
Non-core direct costs	**(26.1)**	(25.1)	(1.0)
Total direct costs	**(225.6)**	(247.1)	21.5
Operations and Central Costs	**(369.0)**	(408.8)	39.8
Total operating costs	**(594.6)**	(655.9)	61.3
of which: Staff Costs	**(250.6)**	(255.2)	4.6

Total operating costs reduced by £61.3m to £594.6m. Management actions delivered £71.0m of sustainable savings in the underlying cost base compared to 2013. These break down into the following categories:

- process improvements and simplification of processes where the Bank has achieved savings of c. £20.0m;
- third party and ATM savings as a result of active management of supplier contracts coupled with a reduced ATM estate of c. £25.0m; and
- other cost reduction initiatives of c. £26.0m including savings arising from: branch rationalisation, new fraud detection and recovery processes.

Detailed financial review continued

These cost savings were partially offset by:

- activity relating to the separation of the Bank from The Co-operative Group c. £25.0m;
- marketing spend linked to the relaunch of the brand in October 2014 c. £8.0m;
- additional spend associated with specialist consultants and contractors c. £7.0m;
- c. £18.0m in relation to anti-money laundering, mortgage business review and numerous smaller items; and
- 2013 included c. £48.0m of one-off costs which have not recurred in 2014.

Staff costs have decreased year on year by £4.6m to £250.6m. Permanent staff numbers (full-time equivalents) have fallen by 993 to 5,711 and direct pay has fallen by c. £19.0m which has been partially offset by cost increases as a result of additional short to medium term specialist contractor resource and increases in pension costs.

Project costs

Project costs

	2014 £m	2013 £m	Change £m
Operational projects	**(37.2)**	(33.7)	(3.5)
Remediation, integration and resiliency projects	**(140.1)**	(52.9)	(87.2)
Strategic projects and exceptional items	**(49.2)**	(78.1)	28.9
Total project expenditure	**(226.5)**	(164.7)	(61.8)

The Bank summarises its investment spend activity into three broad categories:

Operational projects relate to changes in the regulatory environment and smaller business led initiatives. Expenditure is broadly in line with prior year ensuring the regulatory and mandatory requirements of the Bank are met.

Remediation, integration and resiliency projects include IT remediation and resiliency as well as activity associated with Bank separation. In 2013 the Bank recognised provisions of £39.4m relating to separation from The Co-operative Group of which £21.6m has been utilised in 2014. Further provisions of £94.5m have been recognised in 2014. Included in this amount are provisions of £68.9m relating to the IT infrastructure contract with IBM announced in January 2015. The 10 year contract has a total ongoing cost of £275.0m.

In addition, the Bank incurred costs of £19.1m regarding ongoing IT remediation, delivering against issues identified and agreed with the PRA and £14.4m towards embedding new systems and processes to address IT regulatory compliance.

Strategic projects and exceptional items include projects that are transformational in nature and deliver significant cost or income benefits to the business. Expenditure amounted to £49.2m (2013: £78.1m) reflecting investment to enhance capability across the organisation. Spend in this area focused on outsourcing of business processes (£14.3m), severance associated with organisational design changes (£12.7m) and rationalisation of the branch network (£6.2m). In addition to this, the Bank has invested in its Digital offering with total investment spend of £22.9m, of which £1.6m was expensed to the income statement. In addition the Bank spent £14.4m on a series of smaller initiatives.

Impairment losses

The 2014 net impairment write back of £171.7m compared to a charge of £512.1m in 2013 was primarily driven by the Non-core business with a 2014 net impairment write back of £168.2m (2013: charge of £476.3m).

Non-core assets have been disposed of at favourable prices and, together with a number of loan restructures, resulted in the release of previously recognised impairment provisions driving a net impairment write back of £104.6m (2013: charge of £177.4m). In addition, the Bank has booked revisions to valuations of collateral still held, due to an improvement in economic conditions, resulting in net impairment write backs of £62.3m (2013: charge of £65.4m).

Assets classified as in default during 2014 stabilised resulting in a charge of £28.4m (2013: charge of £195.9m). The improving economic conditions coupled with lower defaults have also favourably impacted the collective impairment provision with a net write back of £33.2m (2013: charge of £73.4m).

A more detailed analysis of impairments is provided in the credit risk section.

Conduct and legal risk

The Bank provided an additional £101.2m (2013: £411.5m) during the year in respect of conduct and legal risk. This predominantly comprises £69.0m relating to previously identified breaches of the technical provisions of CCA, £17.4m with regards to packaged accounts, and includes an additional net £15.2m for mortgage related conduct risk and £5.0m for PPI. The additional CCA provision reflects £44.5m of 2014 interest on non-CCA compliant unsecured loans which will be refunded to the customer, £2.3m of mortgages related CCA provisions and £22.3m in respect of anticipated redress costs. The Bank reduced provisions held in relation to card security products provided via a third party, Affinion International Limited, by £10.0m.

Bank balance sheet

Summary balance sheet

	2014 £m	Restated 2013 £m	Change £m
Cash and balances at central banks	**4,765.3**	5,418.8	(653.5)
Loans and advances to banks	**1,608.4**	1,594.4	14.0
Loans and advances to customers[1]	**25,700.8**	30,286.1	(4,585.3)
Investment securities and derivatives	**4,893.2**	5,055.2	(162.0)
Other assets	**615.2**	1,029.3	(414.1)
Total assets	**37,582.9**	43,383.8	(5,800.9)
Deposits by banks	**615.4**	2,757.5	(2,142.1)
Customer accounts	**29,877.8**	33,001.4	(3,123.6)
Debt securities and derivatives	**3,995.3**	4,746.2	(750.9)
Other borrowed funds	**196.4**	196.3	0.1
Other liabilities	**883.5**	913.9	(30.4)
Total liabilities	**35,568.4**	41,615.3	(6,046.9)
Total equity	**2,014.5**	1,768.5	246.0
Total liabilities and equity	**37,582.9**	43,383.8	(5,800.9)

2013 comparatives have been restated as described in note 3.
1. Includes loans and advances held for sale of £323.4m. See note 15 for further details.

Detailed financial review continued

The Bank's customer asset base is made up predominantly of mortgages, corporate real estate loans and unsecured loans. In addition to these customer assets, the Bank holds liquid assets to meet its ongoing and potential future needs in the form of cash and balances at central banks coupled with investment securities.

To fund the assets on the balance sheet, the Bank relies heavily on customer accounts with funding generated from personal current accounts and customer investment products such as ISAs and fixed terms bonds.

Total assets have reduced by £5.8bn to £37.6bn. In addition to the reduction in loans and advances to customers, cash and balances at central banks has fallen by £0.7bn year on year as a result of liquidity management. Other assets have reduced to £0.6bn, a decrease of £0.4bn representing the sale of the Illius property portfolio coupled with the final instalment of The Co-operative Group's £0.3bn capital contribution.

Total liabilities have reduced by £6.0bn to £35.6bn reflecting a reduction of £3.1bn in customer balances, a reduction of deposits by banks of £2.1bn, and a reduction in debt securities and derivatives of £0.8bn as a result of reduction in wholesale funding requirements in line with asset contraction.

Business segment financial performance

Total Business operating result

	2014 £m	Restated 2013 £m	Change £m
Retail contribution	**341.5**	341.7	(0.2)
BaCB contribution	**47.5**	55.7	(8.2)
Core contribution excluding Treasury/other	**389.0**	397.4	(8.4)
Treasury/other contribution	**(51.9)**	(16.4)	(35.5)
Core contribution result	**337.1**	381.0	(43.9)
Non-core contribution result	**203.1**	(469.5)	672.6
Operations and Central Costs	**(369.0)**	(408.8)	39.8
Project costs	**(226.5)**	(164.7)	(61.8)
Operating result	**(55.3)**	(662.0)	606.7

The Core business (Retail and BaCB excluding Treasury/other) contribution is slightly down on prior year at £389.0m (2013: £397.4m) as a result of a reduction in income, partially offset by net impairment write backs and lower direct costs.

Treasury/other delivered a contribution loss of £51.9m (2013: £16.4m) reflecting the change in both the asset and liability mix of the Treasury balance sheet and allocation of liquidity costs.

The Non-core contribution of £203.1m represents a significant improvement on prior year (2013: £469.5m loss) driven primarily by net impairment write backs of £168.2m compared to 2013 impairment charges of £476.3m.

The detailed commentary regarding the drivers behind the results are included in the following sections.

Core

Core contribution

	2014 £m	Restated 2013 £m	Change £m
Net interest income	**431.8**	487.2	(55.4)
Gains/(losses) on asset sales	**(2.1)**	40.8	(42.9)
Non-interest income	**103.4**	110.8	(7.4)
Net income	**533.1**	638.8	(105.7)
Direct costs	**(199.5)**	(222.0)	22.5
Impairment gains/(losses) on loans and advances	**3.5**	(35.8)	39.3
Contribution result	**337.1**	381.0	(43.9)
Net interest margin	**1.60%**	1.60%	–
Assets	**25,476.2**	28,568.2	(3,092.0)
Liabilities	**33,391.0**	39,418.7	(6,027.7)

The Core Bank contribution was down £43.9m on 2013. This is mainly as a result of a reduction in net interest income of £55.4m across all Core business segments coupled with the non-recurring prior year asset sales in Treasury. However, this was partially offset by a reduction in direct costs of £22.5m mainly arising in the Retail business coupled with a favourable movement of £39.3m on impairment charges (£3.5m net write back in 2014, 2013: £35.8m charge).

Retail

Retail contribution

	2014 £m	Restated 2013 £m	Change £m
Net interest income	**396.3**	428.1	(31.8)
Non-interest income	**105.2**	123.7	(18.5)
Net income	**501.5**	551.8	(50.3)
Direct costs	**(161.9)**	(180.3)	18.4
Impairment gains/(losses) on loans and advances	**1.9**	(29.8)	31.7
Contribution result	**341.5**	341.7	(0.2)
Net interest margin	**2.52%**	2.49%	0.03%
Customer assets	**14,611.4**	16,790.9	(2,179.5)
Customer liabilities	**25,562.3**	27,899.3	(2,337.0)

2013 comparatives have been restated as described in note 3.

2014 Retail contribution has remained broadly stable at £341.5m (2013: £341.7m) with reduced income offset by lower direct costs and net impairment write backs.

Mortgage book performance was mixed. In the second half of 2013, the Bank prioritised its liquidity needs over originating new business and as a result, new mortgage applications were severely impacted in the second half of 2013 and early part of 2014.

Detailed financial review continued

As the Bank became more competitive in its intermediary products, year on year mortgage applications through intermediaries more than doubled to £1,960.1m. Moreover, intermediary mortgage completions improved to £941.0m (2013: £737.6m), of which £810.4m were completed in the second half of 2014.

However, redemption rates increased in the year on higher margin standard variable rate (SVR) mortgages and combined with challenges in the origination of direct to customer mortgages, Retail customer lending decreased 13.0% to £14,611.4m reducing the net interest income of the Retail division.

Maintaining strong levels of liquidity was a focus for the first half of 2014. In the second half of 2014, actions were taken to address excess liquidity across the Bank via customer pricing of fixed term deposits. As a result, Retail customer liabilities reduced to £25,562.3m.

In addition, the Bank's internal cost of funding reduced year on year. Customer liabilities receive less benefit from a lower cost of internal funding and overall this has negatively impacted Retail net interest income due to the net liability position of the balance sheet. The net impact of the above is to decrease Retail Bank total net interest income by £31.8m to £396.3m. Despite this reduction in income, net interest margin has marginally increased due to the mix of assets and liabilities.

The UK current account market has experienced increased competition in 2014. The uncertainty regarding the Bank, coupled with the Bank's decision not to significantly market in the first half of 2014, has resulted in a net 4% reduction in total current accounts to 1.4m. The outflow of total current accounts reduced significantly in the second half of the year. However there remains considerable work ahead to re-establish the Bank's market position in a very competitive market.

2014 impairment improved £31.7m to a net write back of £1.9m (2013: £29.8m charge). This predominantly reflects the release of historical provisions associated with an unsecured debt sale. This credit is offset by 2014 impairment charges which are lower than 2013 due to lower balances in arrears, primarily driven by favourable economic conditions.

Business and Commercial Banking (BaCB)

Business and Commercial Banking contribution

	2014 £m	Restated 2013 £m	Change £m
Net interest income	**46.1**	69.5	(23.4)
Non-interest income	**14.9**	14.9	–
Net income	**61.0**	84.4	(23.4)
Direct costs	**(15.1)**	(23.7)	8.6
Impairment gains/(losses) on loans and advances	**1.6**	(5.0)	6.6
Contribution result	**47.5**	55.7	(8.2)
Net interest margin	**6.29%**	7.80%	(1.51%)
Customer assets	**620.0**	844.9	(224.9)
Customer liabilities	**2,837.0**	3,479.0	(642.0)

2013 comparatives have been restated as described in note 3.

The BaCB business 2014 contribution result of £47.5m (2013: £55.7m) represents a £8.2m reduction on prior year.

Customer liabilities reduced £642.0m to £2,837.0m reflecting fixed term deposit outflows as a result of the continuing impact of Bank credit downgrades. In addition, customer assets decreased £224.9m to £620.0m (2013: £844.9m) largely as a result of out of cycle maturities, including repayment of The Co-operative Group balances.

Net interest income has reduced by £23.4m largely as a result of the reduction in customer balances outlined above. Consequently, the net interest margin has decreased 151bps to 6.29% (2013: 7.80%).

BaCB reported a net impairment write back of £1.6m mainly due to favourable economic conditions.

Treasury/other

Treasury/other business contribution

	2014 £m	Restated 2013 £m	Change £m
Net interest income	**(10.6)**	(10.4)	(0.2)
Gains/(losses) on asset sales	**(2.1)**	40.8	(42.9)
Non-interest income	**(16.7)**	(27.8)	11.1
Net income	**(29.4)**	2.6	(32.0)
Direct costs	**(22.5)**	(18.0)	(4.5)
Impairment gains/(losses) on loans and advances	**–**	(1.0)	1.0
Contribution result	**(51.9)**	(16.4)	(35.5)
Net interest margin	**(0.10%)**	(0.08%)	(0.02%)
Assets	**10,244.8**	10,932.4	(687.6)
Liabilities	**4,991.7**	8,040.4	(3,048.7)

2013 comparatives have been restated as described in note 3.

Net interest income reduced due to a change in asset and liability mix of the Treasury balance sheet and the implementation of a revised policy on distributing the cost of holding liquidity. However, this reduction was offset by the impact of a review of hedging accounting methodologies applied by the Bank.

Treasury continued to reduce assets not eligible for liquid asset buffer (LAB), resulting in an asset portfolio consisting materially of highly liquid gilts, multilateral development banks and cash. Due to its current credit ratings, the Bank is required to maintain collateral postings within central payment systems. These assets typically consist of lower yielding government bonds and Treasury bills thereby further impacting net interest income. The Bank repaid £350m of its Funding for Lending Scheme (FLS) liability at the end of 2014.

The allocation policy for the cost of holding the Bank's LAB was changed in 2014, resulting in Treasury absorbing the cost of holding liquid assets above the liquidity risk appetite (LRA) amount directly attributable to products (as opposed to allocating out the entire LAB cost). The impact of this change was a reduction in net interest income for Treasury of £12.2m.

A review of hedge accounting methodologies (see note 3) resulted in a £3.6m increase in net interest income in 2014 and a prior period reduction of £14.6m.

Detailed financial review continued

Non-interest income increased £11.1m when compared to 2013 primarily due to the hedge accounting restatement, noted above (see note 3), which resulted in a profit after restatement of £2.5m (2013: £9.8m loss) on cross currency micro hedging. Due to deleveraging of the balance sheet in 2014, the Bank paid the maximum FLS fee, which is included in non-interest income.

Non-core

Non-core balance sheet

	2014 £m	Restated 2013 £m	Change £m
Corporate CoAM	**3,930.1**	5,646.1	(1,716.0)
Optimum	**6,822.9**	7,326.1	(503.2)
Illius	**–**	162.2	(162.2)
Assets	**10,753.0**	13,134.4	(2,381.4)
Corporate CoAM	**557.4**	831.0	(273.6)
Optimum	**–**	–	–
Illius	**–**	–	–
Liabilities	**557.4**	831.0	(273.6)
Customer assets	**10,253.0**	12,473.4	(2,220.4)
Customer liabilities	**557.4**	831.0	(273.6)

The Bank exceeded its target in the reduction of Non-core assets. These assets have a higher proportional risk weighting compared to Core Bank assets and therefore deleverage mitigates the exposure to credit risk in this area. Non-core total assets decreased by £2,381.4m to £10,753.0m. The majority of this reduction is in the Corporate CoAM Business Unit (£1,716.0m) where the Bank has a focused team actively working to deleverage the balance sheet.

In addition, the Bank's Non-core residential mortgage portfolio's (Optimum) total assets reduced by £503.2m to £6,822.9m as customers continued to pay down their mortgages. The Bank's revised plan requires a reduction in Optimum assets. Optimum was particularly vulnerable to the Bank of England's hypothetical severe stress and an acceleration in timing of its reduction will significantly improve the Bank's resilience to a severe economic downturn. A disposal of the Bank's Optimum assets has revenue implications which require further reduction in the Bank's cost base if the Bank is to achieve its longer term cost income ratio target of below 60%.

The Illius business (a closed residential property portfolio) was disposed of in the year. The transaction resulted in £162.2m of assets being sold at a marginal loss of £1.2m after transaction costs. The Illius business contributed a total loss for the year of £6.5m (2013: £10.1m loss).

Non-core liabilities have reduced by £273.6m to £557.4m in line with expectations. As the Bank continues its Non-core deleveraging strategy customers have chosen to migrate their accounts to other financial institutions.

Non-core contribution

	2014 £m	Restated 2013 £m	Change £m
Net interest income	**48.6**	(3.8)	52.4
Gains/(losses) on asset sales	**(12.3)**	–	(12.3)
Non-interest income	**24.7**	35.7	(11.0)
Net income	**61.0**	31.9	29.1
Direct costs	**(26.1)**	(25.1)	(1.0)
Impairment gains/(losses) on loans and advances	**168.2**	(476.3)	644.5
Contribution result	**203.1**	(469.5)	672.6

2013 comparatives have been restated as described in note 3.

The 2014 contribution is a significant improvement on prior year at £203.1m (2013: loss of £469.5m) primarily driven by net impairment write backs in the year of £168.2m. These are associated with assets being disposed of at favourable prices resulting in the write back of previously recognised impairment provisions. In addition, the Bank has revised valuations of assets still held.

Optimum is part of the Non-core business and the mortgage book is closed for new business. Net interest income for the Non-core Bank has improved during the year to £48.6m (2013: loss of £3.8m) primarily as a result of the Optimum portfolio being charged a lower cost of funds in line with the Bank's reduced cost of internal funding.

Non-core fee related income is down on prior year as a result of lower asset balances across the business and will continue to fall as the Bank deleverages the asset base.

Outlook

As announced at the time of the Bank of England's stress tests in December 2014, the Bank has a revised plan which has been accepted by the PRA. This plan aims to build a sustainable Core Bank and is designed to create a capital buffer by 2019 which would withstand the severe stress hurdle.

The overarching strategy remains unchanged, the only material change being a significant planned acceleration in the reduction of RWAs by the deleverage of the Optimum portfolio which is particularly vulnerable to any severe housing related stress resulting from an economic downturn. This will reduce the Bank's capital requirements over the longer term.

In addition, the Bank intends to increase resiliency through migrating the management of IT infrastructure. On 23 January 2015 the Bank entered into a contract with IBM to migrate its IT infrastructure from The Co-operative Group into IBM managed data centres. This is referred to in more detail in note 41. In addition to this, the Bank will look to continue to reduce the underlying cost base. In the short to medium term, based on investment spend forecasts and continued unwind of fair value assets, the Bank expects to be loss making for at least the next two years, therefore the Bank's CET1 ratio is expected to reduce before it improves again.

Along with all other financial institutions, the Bank, and the Bank's execution of its plan, is significantly impacted by changes in the economic environment.

Detailed financial review continued

Key Performance Indicators[1]

The key performance indicators presented below reflect the way in which the performance of the Bank has been measured during 2014. As it implements its turnaround, management intends to review these measures.

Capital KPIs

	Definition	Why it is important to the business and management	
Common Equity Tier 1 ratio	Capital requirements are part of the regulatory framework governing how banks and depository institutions are measured. Capital ratios express the Bank's capital as a percentage of its RWAs as defined by the regulatory authorities. CET1 is broadly equivalent to tangible shareholders' funds less certain capital deductions.	The Bank is required to maintain minimum regulatory capital and capital ratios at all times. The CET1 ratio is important for the Bank's ability to withstand any future market wide or individual stresses.	**2014: 13.0%** 2013: 7.2% (restated)
Leverage ratio	A ratio calculated by reference to CRD IV fully- loaded Tier 1 capital (after deductions) divided by adjusted balance sheet exposure.	UK banks have been encouraged to disclose this ratio since 2013 (in respect of 2012), and are required to disclose this ratio from 2015. This ratio must be maintained at 3% or above from 1 January 2018.	**2014: 4.3%** 2013: 2.4% (restated)
Total RWAs	RWAs are required to be calculated for the Bank to provide three types of risk: i Credit Risk ii Market Risk iii Operational Risk The Bank's capital ratios are calculated from the sum of the three RWA categories.	The Bank is required to maintain minimum regulatory capital and capital ratios at all times Calculation of total RWAs is part of the calculation of these ratios. The Bank's plan, accepted by the PRA, reduces total RWAs to below £7.5bn by the end of 2018.	**2014: £12.6bn** 2013: £15.1bn

Returns KPIs

	Definition	Why it is important to the business and management	
Statutory profit/ (loss) before tax	This represents operating profit/(loss) less intangible asset impairment, the cost of customer redress, levies, taxes and various non-recurring items.	This is a primary profitability measure used by management to assess performance.	**2014: (£264.2m)** 2013: (£632.8m) (restated)
Net interest margin[2]	Net interest income (the difference between interest received from loans and other assets and interest paid out on deposits and other liabilities) divided by average total assets.	The net interest margin is the key measure of the Bank's ability to generate revenue.	**2014: 1.2%** 2013: 1.0% (restated)
Cost income ratio[3]	The proportion of the Bank's revenue which is used to fund its operating costs, calculated by dividing steady state costs by total income.	A principal measure of the efficiency of the Bank's overall operations.	**2014: 100.1%** 2013: 97.8% (restated)

By its nature, achieving a target involves risks and uncertainties because it is a forward-looking statement that relates to, and depends on, circumstances, that may or may not occur, in the future. A target is not a guarantee of future performance. The Bank's actual results may differ significantly from those suggested by a target. Please see Going Concern, Principal Risks and Uncertainties and Risk Management for information on factors that may mean any targets may not be achieved when planned for, or at all.

1. KPIs are calculated on a management accounts basis as this is how we manage our business. Therefore these measures do not include several items which are reported in the statutory loss. This may render these metrics difficult to reconcile on a statutory basis.
2. Net interest margin is calculated on a management accounts basis and excludes a number of items which are reported in the statutory loss for the year. These include relevant legal and conduct provisions and fair value unwinds. This may render these metrics difficult to reconcile on a statutory basis.
3. Cost income ratio is calculated on a management accounts basis. It is calculated by dividing operating expenditure by operating income which is expressed as a percentage.

Detailed financial review continued

HR KPIs

	Definition	Why it is important to the business and management	
Staff engagement	The Bank measures the engagement level of its employees based on responses to five questions. Employee Engagement is a measure of colleague sentiment towards The Co-operative Bank based on their advocacy, confidence, commitment, pride and their willingness to give discretionary effort that supports productivity and performance. For 2014, the Employee Engagement index was 50%. A direct comparison to previous years cannot be made due to changes in the measures and third party provider following the separation of the Bank from The Co-operative Group.	Our people are vital to our success. Given the challenges the Bank has faced, it is essential that colleagues continue to feel engaged and committed to the business. The Bank has rolled out revised values to colleagues and has embarked on a significant change programme to improve scores in this area.	**2014: 50%**

Gender diversity

As at 31 December 2014.

	Male		Female	
	Number	%	Number	%
Board Directors	7	78%	2	22%
Executive and senior managers	15	75%	5	25%

The above numbers only include permanent employees.

Detailed Key Performance Indicators

Core Bank KPIs

The Core business represents lines of activity that are consistent with the Bank's strategy and includes Retail, BaCB and Treasury.

	Definition	Why it is important to the business and management	
Net interest margin	Net interest income (the difference between interest received from loans and other assets and interest paid out on deposits and other liabilities) divided by average total assets.	The net interest margin is the key measure of the Core Bank's ability to generate revenue.	**2014: 1.6%** 2013: 1.6% (restated)
Customer deposits	The amount of money customers hold in their accounts with the Bank, also known as liabilities.	The Core Bank needs customers to deposit money with the Bank so that it is able to fund loans to other customers.	**2014: £28.4bn** 2013: £31.4bn
Customer assets	The amount of money the Bank has lent to customers as loans.	The interest received on loans is the Core Bank's primary source of revenue.	**2014: £15.2bn** 2013: £17.6bn
Primary current account holders	Customers holding an account with the Bank who on average turn over £800 or more per month.	A measure of the size of the Core Bank's active customer base.	**2014: 651,214** 2013: 664,775
Credit RWAs	Total assets adjusted by different risk weightings for different types of assets (to reflect their inherent potential for default) with the aim of more accurately reflecting the Bank's exposure to potential losses.	Asset types which attract high risk weightings require the Core Bank to hold more equity capital to absorb potential losses.	**2014: £4.4bn** 2013: £5.2bn (restated)

Non-core Bank KPIs

The Non-core business consists of those asset classes which are not consistent with the Bank's Core strategy and are managed to achieve the most appropriate asset value on an individual portfolio basis or are targeted for run down or exit.

	Definition	Why it is important to the business and management	
Customer Assets	The amount of money the Bank has lent to customers as loans.	The interest received on loans is the Bank's primary source of revenue; conversely, impairments on those loans create losses which reduce capital.	**2014: £10.3bn** 2013: £12.5bn
Credit RWAs	Total assets adjusted by different risk weightings for different types of assets (to reflect their inherent potential for default) with the aim of more accurately reflecting the Bank's exposure to potential losses.	Asset types which attract high risk weightings require the Bank to hold more equity capital to absorb potential losses. Reducing RWAs in Non-core will, all other things being equal, increase the Bank's CET1 ratio.	**2014: £7.2bn** 2013: £8.6bn (restated)

Principal risks and uncertainties

Regulatory Position

In December 2014 the Bank submitted a revised plan to the PRA. The revised plan was accepted by the PRA and runs from 2015-2019. Once delivered, it will help the Bank to comply with FCA and PRA regulatory requirements and expectations.

The following section summarises the Bank's position in relation to deficiencies against regulatory requirements and expectations. These deficiencies have existed for some time, and will continue for some years to come, while the Bank executes its plan.

Capital

The Bank meets its Pillar 1 capital requirements under normal economic conditions. This is the minimum required under the Capital Requirements Regulation. However, the Bank has insufficient capital to withstand a severe stress.

The Bank's revised plan is expected to remediate this position towards the end of the plan period (mainly through Risk Weighted Asset (RWA) reduction to reduce risks that the Bank is exposed to, and cost reduction to mitigate ongoing losses).

The PRA provides Individual Capital Guidance (ICG) for each bank. This represents guidance on the capital (Pillar 2a) a firm should hold over Pillar 1. Although the Bank was temporarily above ICG at 31 December 2014, the Bank has insufficient capital to sustainably meet its ICG until the later years of its plan.

The Bank's plan remediates this issue by 2018.

Capital Requirements Regulations (CRR)

The Bank is not currently compliant with all of the requirements to model credit risk internally.

The Bank plans to remediate this issue during 2015.

Solo Consolidation

Until its expiry in September 2014, the Bank had regulatory approval to operate under a 'solo-consolidation' permission, which allowed it to be regulated for prudential purposes as though the Bank and specified solo-consolidated subsidiaries formed a single legal entity. In March 2015, the Bank was granted a new permission to apply solo consolidation, though with respect to a smaller number of subsidiaries. The Bank and its subsidiaries do not have the processes in place to comply with regulatory reporting obligations resulting from this change, or with large exposure requirements in respect of exposures to certain FCA-authorised subsidiaries. The Bank intends to address these issues to a timetable set by the regulators. The Bank has already acted to ensure its FCA-authorised subsidiaries comply with capital requirements on an individual basis.

Technology

As indicated previously, the Bank's infrastructure is in need of an upgrade in numerous respects. Across the Bank's IT infrastructure there are varying levels of resilience and recoverability and whilst a basic level of resilience to a significant data centre outage is in place, the Bank does not currently have a proven end-to-end disaster recovery capability.

The migration of IT infrastructure to an IBM platform (announced on 23 January 2015) is expected to deliver proven end-to-end disaster recovery capability by the end of 2016.

The Bank has received written confirmation from the FCA that the technology issue detailed above constitutes a breach of the FCA's Threshold Conditions[1]. The FCA is closely supervising the firm as it works towards restoring compliance with the Appropriate Resources (non-financial resources) Threshold Condition on this issue. The FCA is not currently proposing further immediate supervisory intervention or the immediate exercise of any additional regulatory powers as a result of this assessment. The FCA reserves the right to take action in the future in relation to this breach. The PRA's general policy is not to communicate its assessment of its position in relation to the PRA Threshold Conditions. However, both the PRA and FCA are closely monitoring the position of the Bank and the Bank remains in continual dialogue with both regulators.

1. Threshold Conditions are set out in Schedule 6 of the Financial Services and Markets Act 2000 as amended by the Financial Services and Markets Act 2000 (Threshold Conditions) Order 2013. Threshold Conditions set out the minimum standards to be met relating to financial and non-financial resources, including capital, risk management, liquidity, and technology. The Threshold Conditions differ depending on whether a firm is PRA-regulated or not.
The Bank is regulated by both PRA and FCA, and certain of the Bank's subsidiaries may in future also be regulated on an individual basis by the FCA.

Principal risks and uncertainties continued

Background

The Bank faced an extremely difficult and unprecedented situation following its June 2013 announcement of a significant shortfall in CET1 of £1.5bn. Since then, elements of the uncertainty around the Going Concern status of the Bank have been removed with the successful completion of the two capital raising exercises – the LME in December 2013 and the equity capital raising in May 2014 together with the receipt of The Co-operative Group's £333m capital contribution.

In December 2014, following the Bank's failure of the Bank of England stress tests, the PRA accepted a revised plan. The overarching strategy of the Bank remains the same, however the Bank has committed to an earlier deleverage of the Optimum portfolio than that contemplated by the original plan. This will have an impact on the Bank's income which will need to be offset by additional cost savings to enable the achievement of the cost income target by the end of the plan period.

Overall, the turnaround is still in its early stages and there are significant challenges in its execution. The Bank has a large number of remediation and redress programmes to implement along with substantial re-engineering of its operating model to reduce costs and improve efficiency and a very large and complex IT remediation programme. A failure to successfully implement or a delay in implementing the Bank's strategy and plans may adversely impact the Bank's business, operating results, financial condition and prospects, its regulatory capital position and its ability to comply with its regulatory requirements both in respect of capital and more generally (see previous page for more information).

The Bank's ability to implement its plan is also influenced by external factors which may mean underpinning assumptions relating to economic or market conditions may be incorrect and negatively impact the plan (for example interest rates may not rise in accordance with assumptions underpinning the plan). Many of these are similar to those faced by other financial institutions, for example, deterioration in general economic conditions, instability of global financial markets and the management of credit risk, interest rate risk, currency risk and market risk and risks from regulatory change and an increasing regulatory enforcement and litigious environment.

The table below outlines how the Bank's Risk Management Framework (RMF) categorises the key financial and non-financial risks to which the Bank is exposed. The crystallisation of any of these risks could result in an adverse effect on the Bank's business, financial condition operating results, reputation and prospects. The RMF is the Board approved segmentation of the risks that the Bank faces into 10 Principal Risks to allow the Bank to identify, assess, manage, monitor and report on its risks across the business. Details of how these risks are managed can be found in the risk management section.

Principal risks and uncertainties continued

Many of these risks are not peculiar to the Bank but are common across all banks. More detail on those more idiosyncratic risks can be found below:

Principal Risks	Definition	Why this is important and how it is managed
Credit risk **(page 95)**	The current or prospective risk to earnings and/or capital arising from a borrower's failure to meet the terms of any contract with the Bank or the various subsidiaries of the Bank or such borrower's failure to perform as agreed.	**Managing this risk is a fundamental part of what a bank does.** The Bank's exposure to this risk is reducing as the higher risk lending is deleveraged, however along with all other banks the Bank remains exposed to macro-economic, market wide risks such as issues with the housing market and interest rate changes.
Liquidity and funding risk **(page 118)**	The risk that the Bank's resources will prove inadequate to meet its liabilities as they contractually fall due or as a result of any contingent or discretionary cash outflows that may occur in a stress. It arises from the mismatch of timings of cash flows generated from the Bank's assets and liabilities (including derivatives). Should additional liquidity be required during a time of stress this is likely to result in higher than anticipated funding costs which will negatively impact on retained earnings and therefore capital resources.	**The Bank is reliant on its retail deposit base as a major source of funding** and given the relative size of the Bank's retail deposit base as compared with other sources of funding, the Bank is particularly exposed to liquidity risks as a loss of confidence by customers may result in the loss of a high proportion of the Bank's funding.
Market risk **(page 123)**	The risk that the value of assets and liabilities, earnings and/or capital may change as a result of changes in market prices of financial instruments. The majority of the Bank's market risk arises from changes in interest rates which is managed and hedged in line with the market risk policy to minimise earnings volatility.	**The treasury team manages interest rate risk.** More information can be found in the risk management disclosures. The success of the Bank's current deleverage strategy is particularly susceptible to market risk.
Operational risk (including legal risk) **(page 126)**	The risk of loss resulting from inadequate or failed internal processes, people and systems or external events. This encompasses the effectiveness of risk management techniques and controls to minimise these losses. Legal risk including litigation is also managed within this risk type.	**The Bank is subject to a number of specific issues in this area due to a lack of investment in systems and processes which has led to increased operational risk. In particular:** **The Bank's IT system has been underinvested for a considerable period of time.** The Bank needs to urgently and significantly improve and re-engineer its existing IT platform as the existing infrastructure is unsuitable and inherently fragile. There are also concerns about its resilience as the Bank's IT disaster recovery plan is not proven end to end. In January 2015, the Bank entered into an Enterprise Services (ES) contract with IBM in order to address this risk, however until that work is completed the Bank is exposed to a higher risk of an IT failure causing material disruption to the Bank's products and services. There are considerable execution risks in a project of this scale and complexity. The Bank's regulators are fully aware of the steps the Bank is taking to address these operational risks as discussed on page 26. **Many of the Bank's business, operational, reporting and financial processes rely on significant manual intervention** which is inefficient and increases the risk of errors in the Bank's data and financial reporting. The Bank is subject to high levels of model risk which occurs as a direct result of weaknesses in the design or use of a model.

Principal risks and uncertainties continued

Operational risk (including legal risk) continued **(page 126)**		**The Bank's systems of control have been weak** and although the foundations of more robust controls, including the revised and updated RMF, have been laid, this is taking more time than anticipated and significant work to embed across the organisation. These include the need to enhance general IT controls, including logical access and controls over the management of financial and customer data. Poor systems and manual processes, many of which have not been integrated following the Bank's merger with the Britannia in 2009 exacerbate this risk. Until the risk framework is fully embedded there is increased risk that inadequate risk management could lead to exposures outside the Bank's risk appetite, unanticipated losses and regulatory censure. **The Bank is in the process of separating from The Co-operative Group.** Currently, and into the medium term, the Bank depends on The Co-operative Group to provide a number of services including critical functions such as IT (until the ES arrangement with IBM described above becomes operational), personnel, assets and to on-supply certain services, data and assets by third party suppliers. The Bank also has significant counterparty exposure to The Co-operative Group. The ongoing separation project is complex and may be more costly than currently contemplated. The Bank faces legal, financial and reputational risk where legal proceedings are brought against it. Liability for damages may be incurred by the Bank where third parties are harmed by the conduct of the Bank's business. The Bank does not have a documented right to occupy a number of its main places of business which if unresolved could lead to disputes, additional cost and operational disruption.
Reputational risk **(page 127)**	The risk associated with an issue which could in some way be damaging to the reputation of the Bank. Underlying issues amongst others arising as a result of: (i) the Bank's strategic decisions or business performance; (ii) an operational failure; or (iii) external perception. This may result in a requirement to hold additional liquidity in anticipation of a stress scenario, which is likely to negatively impact retained earnings over time and therefore capital resources.	**The Bank considers that its reputation as an ethically led organisation is critical to the success of the plan.** Generically, there is a risk that this reputation may be undermined. Specifically, the Bank's change in ownership structure and the necessity to make significant cost savings which will include inter alia branch closures and staff reductions increase this risk. The Bank will continue to rely on the Co-operative brand and therefore carries the risk that its brand will be damaged as a result of matters relating to The Co-operative Group. The Co-operative Bank trade mark belongs to the Bank. Please see the Corporate Governance Report on page 40 for a fuller explanation of the principles governing the Bank's right to use the trade mark and the circumstances in which this could be challenged or removed.

Principal risks and uncertainties continued

Strategic and business risk **(page 128)**	The risk arising from changes to the Bank's businesses and the environment in which it operates, specifically the risk of not being able to carry out the Bank's business plan and desired strategy. This may result in the Bank having to hold additional capital and/or liquidity. This risk is covered by many areas of capital in Pillar II, specifically execution, concentration and liquidity risk.	**The Bank's plan to focus on becoming a smaller Core Bank is unproven and is in the early stages of implementation. The Bank does not have a track record in successful execution of the large scale change necessary.** The plan involves concurrent transformational change, with a large component relating to IT, which may result in additional investment cost and delays to the plan. Any delay would require ongoing regulatory acceptance of these issues for a longer period of time which might not be forthcoming and could be withdrawn if the plan is not executed in line with regulatory expectations. In order to meet the plan accepted by the PRA, the Bank must deleverage its Non-core assets, in particular the Optimum portfolio, in accelerated time scales. Additional Tier 2 capital is contemplated by the Bank's revised plan. Further additional equity and/or debt capital may be required, beyond that contemplated currently, because of increased capital requirements (applicable to the Bank or banks generally), actual costs and losses exceeding those estimated in the Bank's plan or if the Bank does not deliver on its plan as anticipated. The Bank may be unable to raise any Tier 2 or other forms of capital it may need on favourable terms, when needed, or at all.
People risk **(page 129)**	People risk is the risk associated with the recruitment, employment and management of individuals within the Bank. A significant portion of the Bank's cost base is staff costs and so managing this resource within budget is key to cost reduction and therefore to retained earnings. This risk is captured within the operational risk framework.	**The Bank continues to be subject to increased risk in this area.** The Bank continues to suffer an elevated risk of being unable to retain and recruit suitably qualified personnel. This increases execution risk in the plan and reduces historical corporate knowledge.
Regulatory risk **(page 129)**	The risk of fines, public censure, limitation on business, requirements for legal or operational restructuring, or restitution costs arising from the failure to understand, interpret, implement and comply with UK and EU regulatory requirements.	**Along with the wider banking industry, the Bank must comply with multiple regulatory changes** which may add complexity to an already difficult technology, operational and prudential change programme. There is also a risk that changes to regulatory requirements affect the Bank's ability to successfully implement its plan. **The regulatory position of the Bank is described on page 26.** At the end of 2014, the Bank met its ICG, however this is a temporary position and the Bank will not sustainably meet its ICG until the later years of its Plan. The PRA has accepted this position. The Bank is under intense regulatory scrutiny and expects such scrutiny to continue. The Bank is also the subject of multiple regulatory and other investigations and enquiries into events at the Bank and circumstances surrounding them, including enforcement investigations by the FCA and PRA. These investigations and inquiries (see note 36 for more detail) are likely to result in: significant expense which may include damages, fines and other penalties; even greater scrutiny from regulators; further regulatory action or litigation; significant resource drain; further adverse publicity and reputational damage.

1. See page 26 for more information.

Principal risks and uncertainties continued

Conduct risk **(page 130)**	The risk that the Bank's behaviour, offerings or interactions will result in unfair outcomes for customers.	**The Bank is exposed to the inherent risks relating to the mis-selling of financial products,** acting in breach of regulatory principles or requirements and giving negligent advice or other conduct determined by the Bank or the regulators to be inappropriate, unfair or non-compliant with applicable law or regulations. Any failure to manage these risks adequately could lead to further significant provisions, costs and liabilities and/or reputational damage. The Bank's approach to provisions for historic mis-selling issues such as PPI, interest rate swaps and packaged accounts is based on the views and requirements of the regulator. Any change in the regulator's current approach, such as an extension of the period covered by the requirement for proactive contact with customers, could have a material impact. The Bank is continuing its programme of a structured risk based assessment, of which the primary focus is the discovery and remediation of existing and new conduct and legal issues. While much work has been undertaken and progress has been made in identifying conduct issues, no assurance can be given that further issues will not be identified, or that the already identified issues may not require further provision. Projects to remediate these issues are underway however are costly, complicated and require significant data extracts and IT support to implement. Delays or failure to successfully implement redress to customers increases the costs to the Bank and may lead to regulatory sanction. The Bank has initiated a redress programme in respect of various breaches of mortgage conduct of business rules. It is also the subject of a skilled persons review into potential detriment to its mortgage customers arising from, amongst other matters, arrears handling. The outcome of the review is uncertain but could potentially lead to enforcement investigations by the FCA. The Bank continues to be exposed to the risks of non-compliance with the Consumer Credit Act (CCA). While the Bank has identified certain instances where its documentation or processes have not been fully compliant with the technical requirements, there may be other instances of non-compliance which have not yet been identified. Until remediation of the issues already identified is complete, the Bank remains in breach of the technical requirements of the Act and will be unable to enforce interest charges on the affected products. The consequences of non-compliance with the CCA can include interest and default charges paid by a customer in prior periods being required to be refunded and the customer agreement not being enforceable by the Bank without a court order until the breach is remedied.

Principal risks and uncertainties continued

Pension risk **(page 130)**	The risk to the Bank's capital and company funds from the Bank's exposure to scheme liabilities (to the extent liabilities are not met by scheme assets) and risks inherent in the valuation of scheme liabilities and assets.	**The Bank participates in two defined benefit pension schemes, both of which are currently in deficit and there is a risk that this will worsen over time:** • The Pace scheme, whose sponsoring employer is The Co-operative Group. The Bank is a participating employer in this scheme. • The Britannia scheme, now closed, whose sponsoring employer is CFSMS, guaranteed by the Bank. • Refer to note 35 to the accounts for a more detailed discussion of the accounting for these schemes. • The Bank has agreed to a share of the deficit funding up to July 2015 as described in note 35 and a liability for this has been recognised on the balance sheet. Once the Bank's share of Pace liabilities has been agreed, the Bank will account for the scheme on a defined benefit basis. The Pace scheme is not currently sectionalised and operates on a 'last man standing' basis. The Bank's obligation to Pace would increase significantly if another large employer in the scheme were to become insolvent. There is uncertainty over how much the Bank will need to pay in the event of sectionalisation of the scheme. The Bank is in consultation in respect of closure of the defined benefit section of the scheme.

Social, community and human rights

In plain English:

In 1992 we became the first bank to have a customer-led Ethical Policy which defined which businesses and organisations we would provide banking services to, based on our customers' ethical concerns.

The Policy has been shaped around our customers ever since and, in June 2014, over 74,000 customers, colleagues and other stakeholders shared their views on the Ethical Policy and our wider values in our Values and Ethics Poll.

As a result, in January 2015, in line with our customers' ethical concerns, as well as re-committing to the existing statements, we strengthened and expanded the Policy. Our Ethical Policy now provides a framework covering how the Bank operates including, our products and services, relationships with suppliers and external stakeholders, as well as our workplace culture. Customers also wanted the Bank to return to its campaigning heritage so the Policy now includes a commitment to campaign for social and economic change.

Values and ethics are central to the success of the Bank in the future and remain at the heart of our business. Therefore in November 2013 we embedded in the Articles of Association of the Bank a pledge that requires us to act in line with the values associated with the co-operative movement. Values and ethics will continue to be firmly embedded in our approach as they have been since the Bank's inception over 140 years ago.

Review of the year

Our employee volunteering programme is a key pillar of our approach to community investment. Colleagues can take part in team challenges or can volunteer through a variety of individual opportunities. In 2014, 384 Bank colleagues contributed a total of 4,048 hours to their local communities through volunteering and fundraising activities. As part of this total, 31 team challenges were carried out over the year.

Individual volunteering opportunities include Fit 4 Finance where, in 2014, volunteers helped 863 secondary school pupils understand the world of money management. Bank colleagues also carry out Number Partners volunteering, which involves working with primary school children to improve their numeracy skills.

Environmental protection and GHG reporting

Protecting the environment is one of the underpinning goals of our Ethical Policy. In pursuit of this goal, we do not lend to businesses or projects that conflict with our commitments on environmental sustainability. We also seek to minimise our own environmental impacts.

We sourced 99% of our electricity from renewables in 2014. We also maintained our 'beyond carbon neutral' policy for the eighth consecutive year, by offsetting our operational greenhouse gas (GHG) emissions[1] plus an extra 10% to address legacy issues. We do this by supporting carbon reduction projects, sourced through climate and development experts ClimateCare.

We have been reporting our greenhouse gas (GHG) emissions for over 15 years. We measure our direct GHG emissions in carbon dioxide equivalent (tCO_2e) using the latest UK Government guidance[2]. Our direct GHG footprint encompasses energy consumption, refrigerant leakages from major occupancies and all business travel (air, rail and road). All greenhouse gas data and related commentary is externally assured[3].

Total greenhouse gas emissions by source

	Total emissions (tCO_2e)	
Source of emissions	**2014**	Restated[4] 2013
Fuel combustion	**2,774**	3,303
Electricity consumption[4, 5]	**24,335**	24,242
Refrigerant leakages[6]	**373**	504
Business travel	**1,121**	1,753
Total	**28,603**	29,802
Carbon intensity (tCO_2e/FTE[7])	**4.87**	4.32

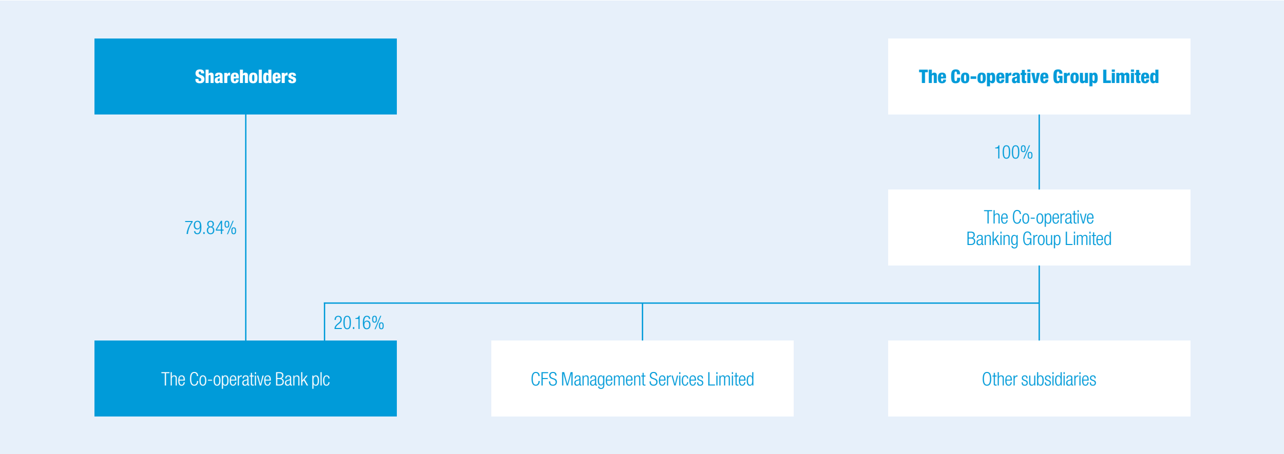
1. Remaining emissions from gas, brown electricity, business travel, and major occupancy refrigerants once green electricity supply is discounted.
2. Department for Environment, Food and Rural Affairs, Environmental Reporting Guidelines: Including Mandatory greenhouse gas emissions reporting guidance, June 2013. (www.gov.uk/government/uploads/system/uploads/attachment_data/file/206392/pb13944-env-reporting-guidance.pdf). Since 2013 all UK quoted companies have been required to report on their GHG emissions as part of their Annual report and accounts. (The Companies Act 2006 (Strategic Report and Directors' Report) Regulations 2013).
3. Assurance is provided by DNV GL.
4. Data restated not total emissions (tCO_2e) due to increasing accuracy of boundary-setting following separation of The Co-operative Bank and The Co-operative Group at the end of 2013.
5. If electricity from renewable sources is accounted as zero carbon then emissions from electricity would be 300 tCO_2e.
6. Refrigerant gas data includes major occupancy properties only.
7. Average number of full time equivalent (FTE) employees for the year.

Group structure

The Bank's ownership structure changed in December 2013 as a result of the LME and shareholdings changed as part of the May 2014 capital raising. The chart below set out the structure as it was at 31 December 2014.

The Co-operative Group remains the single largest shareholder of the Bank. Shareholders are former owners of the Bank's subordinated bonds who received or subscribed for shares as part of the LME.

Ownership of the Bank as at 31 December 2014



At December 2013, The Co-operative Group owned 30% of the Bank. This was reduced to 20.16% as a result of the May 2014 capital raising.

Corporate governance

Biographies of the Board

Dennis Holt
Chairman

Dennis joined the Board in February 2014 as Senior Independent Director. He was appointed as Chairman on 27 October 2014. Dennis' experience in banking and insurance spans 43 years and includes a period as Main Board Executive Director at Lloyds TSB responsible for the Retail Bank. He has held several non-executive posts including Deputy Chairman of Bank of Ireland plc, Chairman of Bank of Ireland UK and Chairman of Liverpool Victoria. He is currently Non-Executive Chairman of Beazley plc and its subsidiary Beazley Furlonge Limited.

Committee membership: Nomination (Chairman), Remuneration, Values and Ethics.

William Thomas
Non-Executive Director

Bill joined the 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. Bill is Chair of the Advisory Board at Cranfield University School of Management and is on the management and Board of Leeds University Business School. Bill is also an unsalaried advisor to the Labour party on matters relating to defence, business and skills policy. He is currently a Non-Executive Director of Xchanging plc and GFI SA, and a partner in Hopton Estates.

Committee membership: Risk, Nomination, Values and Ethics.

John Richard Coates
Interim Senior Independent Director

Richard joined the Board in January 2013. Richard was appointed as Interim Senior Independent Director in October 2014. He has over 25 years of experience in the retail financial services sector. Richard was a senior partner at KPMG from 1985 to 2003 in its retail financial services practice. He joined Northern Rock plc as a Non-Executive Director in August 2008 and chaired its Audit Committee from January 2010 until its acquisition by Virgin Money in January 2012. He is currently a Non-Executive Director of the Police Mutual Assurance Society.

Committee membership: Audit (Chairman), Risk.

Laura Carstensen
Non-Executive Director

Laura Carstensen was appointed to the Board in May 2014. Laura is a former partner at the City law firm, Slaughter and May. Laura is a Senior Advisor, National Audit Office, and a former Member and Deputy Chair of the Competition Commission (now The Competition and Markets Authority) and a Trustee, National Museums Liverpool. She is currently a Non-Executive Director and chair of the Audit Committee of Park Group PLC, a Non-Executive Director of MLEX Limited and a partner in Bryn Yorkin Manor Estate LLP.

Committee membership: Values and Ethics (Chair), Remuneration.

Richard Graeme Barclay Hardie
Non-Executive Director

Graeme joined the Board in May 2013. He was previously Managing Director of NatWest retail bank and Executive Director, retail banking at Abbey National Bank plc. He was a senior advisor, retail markets at the Financial Services Authority (as it was known) and Non-Executive Director at Metro Bank (UK) Limited. He is currently a Non-Executive Director of FNZ (UK) Ltd and is a director of Northpoint Consultancy Services Limited.

Committee membership: Risk (Chairman), Audit, Remuneration.

Biographies of the Board continued

Maureen Laurie
Non-Executive Director

Maureen joined the Board in June 2014. She brings over 30 years of experience in senior human resources (HR) roles spanning global HR strategy, policy and transformation for organisations such as the British Council, NYSE EURONEXT, LIFFE, Barclays, Standard Chartered Bank, EBRD and Reuters. Maureen is currently a Non-Executive Director and Trustee of Reuters Pension Fund and a Non-Executive Director, Governor and Trustee of London Metropolitan University.

Committee membership: Remuneration (Chair), Nomination, Values and Ethics.

Derek Weir
Non-Executive Director

Derek joined the Board in July 2014. 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. Derek is currently a Non-Executive Director of Motherwell Football and Athletic Club Limited, Motherwell Football Club Community Trust and a director of Kerrach Limited.

Committee membership: Audit, Risk.

Niall Booker
Chief Executive Officer

Niall joined the Board in June 2013. He has held a variety of senior roles at HSBC in a career of more than 30 years spanning retail and corporate banking. Most recently, he was Group Managing Director and Chief Executive Officer of HSBC North America Holdings Inc. In this role he had responsibility for working through the issues in HSBC Finance Corporation, where he was Chief Executive Officer, including working closely with the regulators of HSBC North America Holdings. Niall has been a member of the Committee of the Council of Glenalmond College since 2012 and its Chairman since 2013.

John Baines
Finance Director

John Baines joined the Board in October 2014. John joined The Co-operative Bank in April 2013 as Chief Financial Officer and has over 25 years of experience in financial services. Prior to joining The Co-operative Bank, he was most recently Chief Financial Officer of Aldermore Bank plc, having spent the previous eight years at RBS, where he was initially Chief Financial Officer of the wealth management division, being appointed as Chief Executive Officer of the division in 2006. John is a qualified chartered accountant and has held a number of senior roles in investment banks.

Directors' report

The Directors present their report and audited accounts for the year ended 31 December 2014.

General information

The Co-operative Bank plc (registered number 990937) and its subsidiaries provide a range of banking and financial services in the United Kingdom. See page 9 for a full description of our business model and focus.

Dividends

The Directors continue to focus on the revised plan for the Bank and as such the Directors do not expect to pay dividends in the near future. In any event, the Bank has agreed with the PRA not to make any dividend payments until further notice without the prior consent of the PRA. Therefore the Bank is not able to recommend payment of a dividend given the continuing losses (2013: £nil).

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 and post balance sheet events are referred to in the Strategic Report starting on page 4. Financial risk management objectives and policies can be found as detailed below:

	Pages
Business review and future developments	**14**
Key performance indicators	**23**
Principal risks and uncertainties	**26**
Financial risk management objectives and policies	**86**
Post balance sheet events	**279**

Going Concern

There continues to be material uncertainty around the execution of the Bank's turnaround, and its ability to continue as a Going Concern.

The Directors' judgement that it is appropriate to use the Going Concern basis in preparing the Bank and Company's accounts is set out in detail in the Basis of Preparation section of the Annual Report and Accounts.

The Bank and Company's business activities, together with its financial position, and the factors likely to affect its future development and performance, are set out in the Strategic Report on pages 6 to 34. In addition, the risk management section includes the Bank's objectives, policies and processes for managing its risk and details of its exposure to risk. The capital management section provides information on the Bank's capital policies and capital resources including the capital raising activity which resulted in £400m new capital being raised in May 2014.

Consequently, after making enquiries, the Directors are satisfied that the Bank and Company have sufficient resources to continue in business for the foreseeable future and have therefore continued to adopt the Going Concern basis in preparing the financial statements. When making this assessment, the Directors act within the principles of the Financial Reporting Council's 'Going Concern and Liquidity Risk: Guidance for Directors of UK Companies 2009' report.

Political donations

It is the Bank's 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 page 42 of the Governance section of the report.

Details of the Directors offering themselves for election and re-election at the next Annual General Meeting are provided on page 43.

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 on page 64.

Significant contracts

Details of related party transactions are set out in note 38 on pages 219 to 222.

Corporate responsibility

The Bank's corporate responsibility activities are outlined on page 33.

CO_2 emissions

The Bank's greenhouse gas emissions report is detailed on page 33 of the Annual report and accounts.

Employees

The majority of employees are employed by The Co-operative Bank. During 2014 as part of activities to separate from The Co-operative Group, all outstanding transfers of employment contracts in accordance with Transfer of Undertakings regulations, from CFS Management Services Limited (a subsidiary of The Co-operative Group) to the Bank, were carried out (with the exception of one team consisting of approximately 26 people). These activities are further explained in the notes to the financial statements.

The Bank has committed significant investment to implement a cultural transformation programme, led by the CEO and Executive team, which will embed new workplace values throughout the organisation. The roll out of this began in the second half of 2014.

The Bank remains focused on supporting performance improvement through the provision of high quality mandatory risk, conduct and performance management e-training to all colleagues. In 2014, the Performance Improvement policy was updated and a revised Performance Management policy will be implemented in 2015. As part of supporting and improving line manager capability the Bank has extended its management development programme to include masterclasses on key areas such as performance management and change management. A full modular based programme built around five core management skills is available for all our people managers.

A key focus for the Bank during the last year has been the design of a learning, leadership and development framework with programmes which support the creation of a talent pipeline aligned to future capability needs. In 2014 we recruited eight graduates to join our new Graduate Programme, and this will be expanded to a further 14 graduates in 2015.

Directors' report continued

The Bank issued a colleague engagement survey in November 2014 which will provide a baseline for driving better colleague engagement and a cultural values index.

The Bank continues to consult and communicate (using a number of platforms including colleague publications, intranet, surveys, conferences and videos) with colleagues on customer, organisation and business performance issues. In addition, informal and formal consultations with both Unite and the Britannia Staff Union are regularly undertaken. The unions continue to be fully consulted where organisational change and other issues may affect colleagues.

During 2014, the Bank continued relationships with a number of diversity advisory bodies such as Inclusive Employers, Business Disability Forum, Business in the Community and Stonewall who provide the Bank with information on diversity.

As part of its new Ethical Policy, the Bank committed in January 2015 to paying colleagues not less than the living wage.

Employees with disabilities

During 2014, the Bank continued to be a holder of the 'Positive about Disabled People' symbol, a recognition given by Jobcentre Plus to employers who have agreed to meet five commitments concerning the recruitment, employment, retention and career development of disabled people. The Bank has policies and processes in place to support disabled colleagues in the workplace. Further guidance and information for colleagues on disability issues is available through Human Resources and on the colleagues' intranet. The Bank recognises its responsibility for making reasonable adjustments for new colleagues with disabilities and for those individuals who develop disabilities whilst in employment.

Employees' wellbeing

The Bank recognises 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 and their immediate families on a wide range of matters including health and wellbeing, personal and work related concerns, money and debt, child/elder care and trauma. The Bank also provides occupational health support.

Corporate Governance report

The Corporate Governance report can be found on pages 40 to 65 and, together with this Directors' report of which it forms part, fulfils the requirements of the Corporate Governance statement for the purpose of the Financial Conduct Authority's Disclosure and Transparency Rules (DTR).

By order of the Board

Dennis Holt
Chairman
26 March 2015

Corporate Governance report

Chairman's introduction

I joined the Board in February 2014 as the Senior Independent Director and was appointed Chairman in October 2014 following a process to find a successor to Richard Pym, who stood down from the Chairmanship at the beginning of October 2014. I start my introduction to the Corporate Governance report with a note of thanks to Richard Pym who laid firm foundations to enable the Board to oversee the rebuilding of governance structures of the Bank.

The reporting that follows my statement demonstrates the Board's approach to ensuring that there are governance structures in place to provide a robust framework to support our continuing work to deliver the turnaround of the Bank. The Bank continues on its journey to revitalise our franchise and an important step in that journey was the strengthening of our Board. During 2014, in addition to my own appointment, the Board was strengthened by the appointment of three other Independent Non-Executive Directors. Laura Carstensen joined the Board in May 2014 to Chair the Values and Ethics Committee drawing on her previous experience as a lawyer and Commissioner at the Competition Commission. Maureen Laurie, who chairs the Remuneration Committee, joined the Board in June 2014 and brings with her 30 years of experience in senior human resources roles spanning global HR strategy, policy and transformation for a variety of organisations. Following nomination under the terms of the Relationship Agreement with key shareholders, Derek Weir who has long experience in corporate and commercial banking joined the Board in July 2014 as an Independent Non-Executive Director and has joined the Audit Committee and the Risk Committee. The Board also welcomed John Baines as an Executive Director of the Board in October 2014.

Our Board will develop again during the course of 2015 as we progress our search for additional Non-Executive Directors some of whom will be appointed under the terms of the shareholder agreements which are described in more detail on page 45. The report that follows will explain that the Board has agreed that whilst our planning for an external Board evaluation continues, it will not take place until late in 2015 when it is anticipated further Board appointments will have been made and Directors have had the opportunity to complete a reasonable period in office prior to external evaluation. At this year's AGM all the Directors will stand for election or re-election.

During 2014 the Board again worked very closely with and was supported by the Chief Executive and the Executive Committee to revise the plan going forward and address a number of key initiatives and corporate activities. The complexity of issues addressed by the Board during the year has been reflected in the time the Directors have devoted within Board and Committee meetings and in preparation for Board decisions to ensure that there is sufficient reflection on, and scrutiny, analysis, challenge and debate of the matters presented. Our decision making during the year has included consideration of the capital raising in May 2014, approval of the revised plan and the migration of the management of our IT infrastructure to IBM, selection and appointment of new Directors, the Chairman and Senior Independent Director, the development of appropriate executive remuneration structures and the industry wide regulatory events including Bank of England stress tests. The Board remains focused on stakeholder engagement. During the year we were able to revitalise our Ethical Policy from the results of a well-received customer poll to which over 74,000 customers and colleagues responded. We are committed to holding appropriately structured and regular dialogues with shareholders.

As we expected, 2014 saw progress towards a viable business that is sustainable in the longer term and demonstrates the values and ethics on which the Bank was founded and continues to operate its business today. There remains significant work to do.

Dennis Holt
Chairman
26 March 2015

Compliance with the UK Corporate Governance Code

The UK Corporate Governance Code, published by the Financial Reporting Council in 2012 (the Code), sets out standards of good practice in relation to Board leadership and effectiveness, remuneration, accountability and relations with shareholders.

The Directors will continue to support high standards of Corporate Governance. The Bank complied with the principles of the 2012 Code during the year with the exception of B 2.1 being the adoption of a Board diversity policy; B 6.1 being an external evaluation of the Board and A 4.2 in relation to an appraisal of the Chairman's performance, as discussed in the relevant sections of this report. The Board acknowledges that a new Code was published in September 2014, applying to companies with financial years beginning on or after 1 October 2014. The new Code does not yet apply to the Company which will work towards compliance with its provisions and report on such in its Annual Report and Accounts for 2015.

Role and responsibilities of the Board

The Board has collective responsibility for the long term success of the Bank. Its role is to provide leadership of the Bank within a framework of prudent and effective controls which enables risk to be assessed and managed. It sets the Bank's values and standards and ensures that its obligations to its shareholders, customers and other stakeholders are understood and met.

The Board 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 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.

The Board has approved a schedule of Matters Reserved for the Board and authorities delegated to the Chief Executive Officer (CEO). The full schedule of Matters Reserved for the Board is available on the Bank's website. Both the Matters Reserved for the Board and the CEO's delegated authorities have been revisited by the Board and re-adopted for 2015 with appropriate enhancements. Such reserved matters include decisions on strategic and long term objectives, the approval of published financial statements, major acquisitions and disposals, significant investments and other capital expenditure, and approval of the Bank's risk appetite and its Risk Management Framework.

Implementation of the strategy set by the Board 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.

The Board

As reported in the Chairman's introduction to this report, there have been additional appointments to the Board during 2014 and it is expected that there will be further appointments during the course of 2015.

Composition

Details of the members of the Board, their biographies and details of length of service are set out on pages 36 to 37.

During 2014, the following Directors were appointed: Dennis Holt on 3 February 2014 (as reported in the 2013 Annual Report and Accounts), Laura Carstensen on 27 May 2014, Maureen Laurie on 30 June 2014, Derek Weir on 25 July 2014 and John Baines on 1 October 2014. At the end of 2014, the Bank's Board of Directors comprised two Executive Directors (Niall Booker and John Baines) and seven Non-Executive Directors (including the Chairman). There have been no further changes to the number of Directors since the end of 2014.

Dennis Holt was appointed as the Chairman of the Board on 27 October 2014 and he acted as interim Chairman from 1 October 2014 when Richard Pym stood down as Chairman. Richard Coates was appointed as interim Senior Independent Director on 1 October 2014.

Anne Gunther and Merlyn Lowther stood down from the Board at the conclusion of the Annual General Meeting on 30 May 2014. As reported in the 2013 Annual Report and Accounts, Rodney Bulmer resigned on 28 February 2014 and Alistair Asher resigned on 24 March 2014.

The Bank regards Richard Coates, Graeme Hardie, William Thomas, Laura Carstensen, Maureen Laurie and Derek Weir as Independent Non-Executive Directors. Dennis Holt has been regarded as an Independent Non-Executive Director, within the meaning of 'Independent' as defined in the Code during the year and on his appointment as Chairman on 27 October 2014.

The Code recommends that at least half the Board of Directors (excluding the Chairman) should comprise Independent Non-Executive Directors. The Code states that the Board should determine whether a Director is independent in character and judgement and whether there are any relationships or circumstances which are likely to affect, or could appear to affect, the Director's judgement. The Directors consider two thirds of the Board to be independent.

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

The Independent Non-Executive Directors are of sufficient calibre and number that their views carry significant weight in the Board's decision making. The Board considers that this will continue as new members are added to the Board during 2015.

Corporate Governance report continued

Board changes

During 2014 there were a significant number of changes to the Board of the Bank. Five Directors resigned from the Board of the Bank and five Directors were appointed.

Current members of the Board		Independent	Appointed
Dennis Holt	Chairman	On appointment	3 February 2014[1]
Niall Booker	Executive Director		11 June 2013
John Baines	Executive Director		1 October 2014
Richard Coates	Interim Senior Independent Director	Independent	16 January 2013[2]
Graeme Hardie	Non-Executive Director	Independent	1 May 2013
William Thomas	Non-Executive Director	Independent	28 October 2013
Laura Carstensen	Non-Executive Director	Independent	27 May 2014
Maureen Laurie	Non-Executive Director	Independent	30 June 2014
Derek Weir	Non-Executive Director	Independent	25 July 2014

1. Dennis Holt was appointed as Chairman on 27 October 2014 having acted as interim Chairman from 1 October 2014. Prior to that date Dennis Holt was the Senior Independent Director.
2. Richard Coates was appointed as interim Senior Independent Director on 1 October 2014.

Members of the Board leaving the Board since 1 January 2014		Independent	Appointed	Resigned
Richard Pym	Chairman	On appointment	11 June 2013	1 October 2014
Anne Gunther[1]	Non-Executive Director	Independent	6 September 2011	30 May 2014
Merlyn Lowther[1]	Non-Executive Director	Independent	7 September 2011	30 May 2014
Alistair Asher	Non-Executive Director		31 December 2013	24 March 2014
Rodney Bulmer	Executive Director		18 May 2013	28 February 2014

1. During 2014, Anne Gunther and Merlyn Lowther informed the Company that they would not be seeking re-election at the 2014 AGM of the Company and accordingly, each retired as a Director of the Company at the conclusion of the 2014 AGM held on 30 May 2014.

Nominee Directors

For so long as the Co-operative Group Limited remains a bona fide co-operative society, the Co-operative Group Limited has the right, in certain prescribed circumstances and because of the percentage shareholding it currently holds in the Company, pursuant to the Articles of Association, Relationship Agreement and the Shareholder Rights Agreement, to appoint one representative to the Board of the Bank. The Bank's Articles of Association can be found on the Bank's website. The Board understands that The Co-operative Group intends to nominate a candidate during the course of 2015 as The Co-operative Group nominated Non-Executive Director. This appointment will not be regarded as independent for the purposes of the Code.

In connection with the recapitalisation and the Capital Raising, certain other shareholders may nominate up to a total of four persons to be appointed as Directors to the Board. More details are set out in the Shareholder Relations section on page 45. Three of these positions are vacant. Derek Weir was nominated by shareholders and appointed to the Board as an Independent Non-Executive Director in July 2014.

The Role of the Chairman

Dennis Holt, the current Chairman of the Bank, was appointed on 27 October 2014 and for the purposes of the Code was considered independent on appointment. Details of Dennis' professional commitments are included in his biography. The Board is satisfied that these commitments do not interfere with the performance of Dennis' duties for the Bank.

The Bank's Chairman is a Non-Executive Director who leads the Board in the determination of its strategy and in the achievement of its objectives. The Chairman takes personal responsibility for organising the business of the Board, ensuring its effectiveness and setting its agenda. The Chairman has no involvement in the running of the day-to-day business of the Bank. His role is to facilitate the effective contribution of Directors, constructive relations between the Executive and Non-Executive Directors, ensure Directors receive accurate, timely and clear information and that there is effective communication with shareholders. The division of responsibilities between the Chairman and the Chief Executive is clearly defined and was re-adopted by the Board on 5 March 2015.

The Role of the Senior Independent Director

Richard Coates was appointed as the interim Senior Independent Director on 1 October 2014. Dennis Holt acted as the Senior Independent Director from the date of his appointment on 3 February 2014 to 1 October 2014. Details of Richard's professional commitments are included in the biographies. The Board is satisfied that these commitments do not interfere with the performance of the interim Senior Independent Director's duties for the Bank.

The Nomination Committee is currently considering the process for the selection of candidates, including the use of external search consultancies, to fill the vacancy for the permanent Senior Independent Director and anticipates that it will make recommendations to the Board on this matter during 2015.

The Senior Independent Director is available to shareholders if they have concerns that the normal channels of the Chairman, Chief Executive Officer or other Executive Directors have failed to resolve, or for which such channels of communication are inappropriate.

The Senior Independent Director will meet with the other Non-Executive Directors without the Chairman present once a year and on other occasions as appropriate to appraise the Chairman's performance.

The Role of the Chief Executive Officer (CEO) and the Executive team

The CEO has direct charge of the Bank on a day-to-day basis and is accountable to the Board for the financial and operational performance of the Bank. The current CEO is Niall Booker, who was appointed to the Board on 11 June 2013.

It is the responsibility of the Executive team to implement the strategic objectives as agreed by the Board. The Executive team, under the leadership of the CEO, is responsible for the management of the Bank. John Baines is the Finance Director and a member of the Board and the Executive Committee.

The Secretary to the Board

The Secretary is responsible for advising the Board through the Chairman on all governance matters. All Directors have access to the advice and services of the Secretary. The Articles of Association provide that the appointment and removal of the Secretary is a matter for the Board, as do the Matters Reserved to the Board.

The current Secretary is Brona McKeown, (who was appointed on 2 December 2013) and who is also General Counsel of the Bank.

Appointment and re-appointment of Directors

All Non-Executive Directors are appointed to the Board 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 Bank's Annual General Meeting (AGM). All current Directors will offer themselves for election or re-election at the AGM in 2015. 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 36 to 37 and can also be found on our website at:

http://www.co-operativebank.co.uk/aboutus/governance/Directors

How the Board operates

Meetings and attendance

The Board usually meets on a monthly basis and there were 13 business as usual scheduled meetings in 2014 (11 monthly meetings and two strategy meetings). During the year the execution of the turnaround, the capital raising and the revision of the plan in the latter part of 2014 gave rise to the need for additional Board meetings or a Committee of the Board to be convened. Consequently there were 13 additional meetings of the Board or Committees of the Board convened in 2014. The Chairman and Board members also receive updates from the CEO and members of the Executive team between meetings.

The Board is scheduled to hold 11 Board meetings and two strategy meetings in 2015. The strategy meetings will be attended by Senior Executives and will consider performance and longer term planning. If necessary, the Chairman and Non-Executive Directors meet in the absence of Executive Directors as required. Members of the wider Executive and senior management team are invited to Board meetings for specific items. This assists key messages from the boardroom to be articulated to the business and vice versa. In addition members of the Executive seek advice from Non-Executive Directors on a one to one basis.

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 five days before a meeting.

Attendance

The following table sets out the attendance at scheduled Board meetings:

Name	Appointed date	Resigned date	Board Meetings attended[1] (entitled to attend)[2]	Audit Committee attended[1] (entitled to attend)[2]	Risk Committee attended[1] (entitled to attend)[2]	Values and Ethics Committee attended[1] (entitled to attend)[2]	Remuneration Committee attended[1] (entitled to attend)[2]	Nomination Committee attended[1] (entitled to attend)[2]
Dennis Holt	3 February 2014		12(12)	4(4)	–	2(2)	12(13)	5(5)
Richard Coates			13(13)	14(14)	9(10)	4(5)	9(9)	3(3)
Graeme Hardie			13(13)	14(14)	10(10)	5(5)	15(15)	3(3)
William Thomas			11(13)	–	8(10)	5(8)	–	3(3)
Laura Carstensen	27 May 2014		6(7)	–	–	4(4)	5(6)	–
Maureen Laurie	30 June 2014		6(7)	–	–	3(3)	6(6)	3(3)
Derek Weir	25 July 2014		5(5)	1(1)	3(3)	–	–	–
Niall Booker			13(13)	–	–	–	–	–
John Baines	1 October 2014		3(3)	–	–	–	–	–
Richard Pym		1 October 2014	10(10)	–	–	7(7)	–	4(4)
Merlyn Lowther		30 May 2014	5(5)	10(10)	4(5)	4(5)	–	–
Anne Gunther		30 May 2014	5(5)	–	4(5)	4(5)	9(9)	–
Alistair Asher		24 March 2014	2(2)	–	–	1(1)	–	–
Rodney Bulmer		28 February 2014	2(2)	–	–	–	–	–

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.

During 2014, 13 additional Board meetings or meetings of a Committee of the Board were held. The Board agreed the arrangements for those meetings, and agreed, where it was appropriate to do so, the identity or the number of Directors required to attend meetings. Accordingly not all Directors were required to attend all those additional meetings. All Directors had notice of the meetings being held and access to the materials to be discussed and the opportunity to provide their comments on the business to be considered in advance to the Chairman, other members of the Board or the Secretary.

Number of meetings in 2014

Board meetings (scheduled):	13
Audit Committee meetings:	14
Risk Committee meetings:	10
Values and Ethics Committee meetings:	8
Nomination Committee meetings:	5
Remuneration Committee meetings:	15

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.

During 2014, all Directors exceeded the time commitment set out in their letter of appointment.

Corporate Governance report continued

Relations with shareholders

As at 20 February 2015, the Bank has been advised that each of the following shareholders beneficially own in excess of 9.9% of the ordinary shares of the Bank:

Beneficial shareholder	Percentage holding of Ordinary Shares
The Co-operative Banking Group Limited	20.16 %
SP COOP INVESTMENTS LTD	12.79 %

The Annual General Meeting

In support of best practice, all resolutions at the 2014 AGM were voted separately and by way of a poll. The result of the AGM recorded all votes cast for, against and those withheld. A vote withheld is not a vote in law and is not counted in the calculation of the proportion of the votes for or against a resolution.

Shareholder engagement

During 2014, the Board had significant dialogue with The Co-operative Group and other shareholders which helped the Company to develop the structure for raising an additional £400m of capital in May 2014. The capital raising resulted in the issuance of 200m of ordinary shares on 30 May 2014. In addition 1,456,510 ordinary shares were also issued to those shareholders who were precluded from participating in the capital raising. Since the capital raising, the shareholder base has continued to develop. The Chairman and the Executive team led by the Chief Executive and Finance Director (including operating through its Investor Relations team), enable and continue the dialogue with shareholders which is reported back to the Board. All Directors are expected to attend the Bank's AGM.

Co-existence Principles and the use of The 'Co-op' Brand

The Bank owns the trademark rights to The Co-operative Bank brand.

The Co-existence Principles govern the use of trademarks containing 'Co-operative' or 'Co-op' and other associated trademarks owned by both parties. These principles are as follows:

Until a Trigger Event (namely the removal of the Values and Ethics provisions entrenched in the Bank's Articles of Association) The Co-operative Group cannot conduct any business under a brand that combines the words 'Co-operative' or 'Co-op' and 'Bank'. After the Relationship Agreement (see below) ends and until a trigger event the Bank can continue to use the terms 'Co-operative' and 'Co-op' provided it does not confuse the public into believing that the Bank is still a part of The Co-operative Group. After the expiry of the non-compete period of three years after the Relationship Agreement ends, The Co-operative Group is free to conduct any financial services business under any of its brands, subject to the restriction placed on its use of 'Co-operative' or 'Co-op' with 'Bank'. Until five years after the end of the non-compete period, The Co-operative Group cannot conduct any business which competes with the Bank under a main business brand including the words 'Co-operative' or 'Co-op'.

Furthermore, the Secretary of State for Business, Innovation and Skills may direct the Bank to change its registered name if, in his opinion, it gives so misleading an indication of the nature of its activities as to be likely to cause harm to the public. The FCA has the power to prevent the use of the 'Co-operative' name, or to take other action regarding the Bank's branding, if the FCA considers this desirable to protect consumers, to promote competition in the interests of consumers or to protect the integrity of the UK financial system.

Relationship Agreement

In anticipation of the completion of the LME and the Bank ceasing to be a wholly-owned subsidiary of The Co-operative Group, the Bank entered into a relationship agreement with The Co-operative Group and Banking Group on 4 November 2013 (Relationship Agreement) to regulate the basis of their ongoing relationship. The Relationship Agreement will continue for so long as The Co-operative Group remains a significant shareholder of the Bank (i.e. the right to exercise, or control the exercise of, 20% or more of the voting rights at a general meeting). It includes appropriate measures regarding the degree of control that The Co-operative Group and its associates may exercise over management of the Bank.

Under the Relationship Agreement, The Co-operative Group undertakes that it will conduct transactions with the Bank on arm's length terms and not seek to influence the day-to-day running of the Bank. Amendments to existing contracts and arrangements in place between The Co-operative Group and the Bank will require the approval of a majority of Independent Directors of the Bank. The Relationship Agreement contains provisions on conflicts and related party transactions.

The Relationship Agreement requires the Bank to have a Values and Ethics Committee which is required to:

- recommend to the Board for approval and adoption The Co-operative values and ethical policies of the Bank; and
- represent, monitor and advise the Board on matters concerning the interests of customers, suppliers, employees and other stakeholders in their dealings with the Bank.

Further, under the Bank's Articles of Association, there is a requirement to promote and conduct its business to the extent practicable in a manner informed by the established values of The Co-operative Movement having 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.

Under the terms of the Relationship Agreement The Co-operative Group has the right to appoint and remove:

- up to two persons to the Board provided that The Co-operative Group controls directly or indirectly 25% or more of the voting rights exercisable at a General Meeting of the Bank; or
- one person to the Board provided that The Co-operative Group controls directly or indirectly 20% or more, but less than 25% of the voting rights exercisable at a General Meeting of the Bank.

Corporate Governance report continued

The Co-operative Group Limited has the ability to appoint one of its nominee Directors to the Values and Ethics Committee.

- On 30 May 2014 there was a further £400m share capital issuance to existing investors, and this resulted in The Co-operative Group ownership reducing to 20.16% of the ordinary issued share capital of the Bank. As a result, The Co-operative Group currently has the right to appoint one Director to the Board under the provisions of the Relationship Agreement described above.
- The Variation and Director Appointment Deed described below provided that even if The Co-operative Group Limited shareholding falls below 20% it retains the right to appoint one Director to the Board of the Bank, providing it controls 15% or more of the voting rights at a General Meeting of the Bank.

Subject to certain conditions, the Relationship Agreement also provides a mechanism for the appointment of up to two approved persons as Non-Executive Directors (after having been nominated for such purpose by the subscribers of ordinary shares under the purchase agreement with the Bank dated 4 November 2013 (the Purchase Agreement)). A person so nominated can be appointed if less than 25% of relevant votes object to the appointment of such persons within a specified timeframe.

Provisions are included in the Relationship Agreement concerning the fact that The Co-operative Group and the Bank share many of the same customers and it is therefore necessary to mitigate risks and deal with practical issues concerning the processing of data.

The Relationship Agreement contains provisions that restrict or limit the Bank's ability to issue any shares or other equity securities or any securities convertible into, or exchangeable for, or grant any right to subscribe for, shares or other equity securities (subject to specified exceptions) without the consent of The Co-operative Group from the date of admission of the ordinary shares of the Bank to a standard or premium listing segment of the official list maintained by the FCA for up to a maximum period of three years after 20 December 2013. No such consent is required for certain limited issues of Relevant Securities including:

- issues comprising an equity capital raising required, or taken by the Bank in anticipation (acting reasonably) of any such requirement, by a government authority or regulator; and

The Co-operative Group has agreed in the Relationship Agreement that for the duration of the period ending on the later to occur of (1) two years after the termination of the Relationship Agreement and (2) 20 December 2020. The Co-operative Group will, subject to certain exceptions:

- continue to use the Bank as its exclusive provider of financial services (excluding lending) in respect of financial services that are being provided by the Bank to The Co-operative Group on an exclusive basis as at the date of the Relationship Agreement (Exclusive Financial Services) and principal provider of financial services in respect of financial services that are not Exclusive Financial Services;
- continue to use the Bank as its principal provider of financial services in respect of financial services that are not Exclusive Financial Services that have been provided by the Bank to The Co-operative Group in the 12 month period prior to 4 November 2013;
- promote the Bank's banking business and facilitate and encourage its customers and members to hold bank accounts with, and otherwise use the services of, the Bank; and
- support the enhancement and rejuvenation of The Co-operative brand and franchise.

The Relationship Agreement will terminate immediately (but without prejudice to accrued rights and obligations) if The Co-operative Group ceases to be a significant shareholder in the Bank (i.e. hold 20% or more of the voting rights exercisable at a general meeting of the Bank). Certain key obligations of The Co-operative Group under the Relationship Agreement will survive such termination. These include The Co-operative Group's commitments (a) to use the Bank as an exclusive principal provider of financial services as outlined above, and (b) for a specified period of time not to operate a business which principally involves the provision of banking and other services in the UK that were provided by the Bank at the date of the Relationship Agreement or in the 12 months prior to it (excluding any business activities carried on by The Co-operative Group at the date of the LME). Further, termination of the Relationship Agreement will not affect the continued inclusion in the Bank's Articles of Association of entrenched principles, and certain articles describing the purpose and authority of the Values and Ethics Committee, and how it should be constituted, although the provisions in the Relationship Agreement in relation to the right of The Co-operative Group to nominate a Director to the Committee terminates when The Co-operative Group is no longer a significant shareholder in the Bank.

Variation and Director Appointment Deed

The Bank, The Co-operative Group and The Co-operative Banking Group Limited (CBG) entered into a Variation and Director Appointment Deed ('the Deed') on 10 May 2014. The Director appointment rights under the Deed will only apply if The Co-operative Group ceases to exercise, or to control, directly or indirectly, the exercise of 20 per cent. or more of the rights to vote at general meetings of the Bank and the nominee Director appointment rights of The Co-operative Group under the Relationship Agreement have therefore ceased to apply. Until that point, the existing Director appointment rights of The Co-operative Group under the Relationship Agreement will continue to apply.

If the Director appointment rights in the Deed were to apply in those circumstances, The Co-operative Group would have a right, for so long as it remains a bona fide co-operative society and directly or indirectly controls 15 per cent. or more of the voting rights exercisable at general meetings of the Bank, to appoint, remove (and to the extent such Directors are removed or resign, appoint replacements for) one Director to the Board.

In the event that The Co-operative Group ceases to be a bona fide co-operative society or The Co-operative Group ceases to directly or indirectly control 15 per cent. or more of the voting rights exercisable at general meetings of the Bank, the Deed provides that The Co-operative Group's nominee Director would be automatically removed as a Director of the Bank.

The Deed also made certain amendments to the Relationship Agreement. The Relationship Agreement imposed lock-up restrictions on The Co-operative Group disposing of its ordinary shares in the Bank for five years from the effective date of the LME. The Deed provides that with effect from 30 September 2014, these lock-up restrictions ceased to have effect and The Co-operative Group shall from that date be entitled to sell its interest in ordinary shares without the consent of the Bank, provided that The Co-operative Group shall pay or cause to be paid to the Bank following such sale the net proceeds of such sale and such payment obligation shall continue until such time as the Undertaking to Pay (as defined in the 2014 Commitment Agreement) has been discharged in full. This obligation was discharged in full on 31 December 2014 by The Co-operative Group and the lock-up has consequently ceased to apply to The Co-operative Group.

Separation

Prior to the LME, certain functions of the Bank were centralised and carried out by The Co-operative Group. Project Unity and CFSMS Arrangements are the two key arrangements in place under which the Bank receives the supply of services, assets and/or personnel. Two key agreements in connection with Project Unity are the existing IT Services Agreement and a Professional Master Services Agreement in relation to the provision of other services. CFSMS was established as a direct subsidiary of The Co-operative Banking Group in 2005 to enable economies of scale through the sharing of employees and sourcing of third party services across The Co-operative Banking Group, including the Bank.

Following the announcement of the Bank's Recapitalisation Plan in June 2013, the Bank and The Co-operative Group worked to amend certain provisions of Project Unity and CFSMS Arrangements. Those amendments were close to finalisation when The Co-operative Group announced on 21 October 2013 that it was in discussion with bondholders, and that many elements of the Plan would need to change in material respects to reflect the fact that the Bank would no longer be a subsidiary of The Co-operative Group. Accordingly the Bank and The Co-operative Group have been working towards renegotiation of the arrangements under which the Bank receives staff and services from The Co-operative Group. Pending finalisation of the revised arrangements, the Bank and The Co-operative Group agreed high level principles (the Separation Principles) to govern their separation discussions.

The Separation Principles include an overarching agreement to act in good faith and, amongst other things:

- until alternative arrangements for Project Unity and the CFSMS Arrangements are agreed, The Co-operative Group will continue to provide services to the Bank under the same terms that such services are currently provided;
- for those costs allocated by The Co-operative Group in its sole discretion, the Bank and The Co-operative Group will take reasonable steps to avoid the Bank incurring costs incremental to those it currently incurs;
- The Co-operative Group and the Bank will mitigate costs arising for The Co-operative Group or the Bank from (i) The Co-operative Group being a less than 50% shareholder of the Bank; or (ii) agreed steps taken in connection with the separation process;
- an additional mark-up of no more than 20% may be charged by The Co-operative Group for services provided under Project Unity after the LME but not in respect of the first 12 months in respect of all services;
- costs will be allocated between the Bank and The Co-operative Group on an equitable basis; and
- a working group consisting of representatives from the Bank and The Co-operative Group will be established to address and oversee the separation work stream.

For further information on the separation of the Bank and The Co-operative Group, refer to note 38.

Shareholder Rights Agreement

In May 2014, the Bank entered into a shareholder rights agreement (the Shareholders Rights Agreement) with Silver Point, Perry Capital, Invesco Asset Management Limited and York Capital (collectively the Committed Shareholders), The Co-operative Group and The Co-operative Banking Group.

Under the Shareholder Rights Agreement, the Bank has granted certain rights to the Committed Shareholders and The Co-operative Group. These rights are in addition to those contained in the Relationship Agreement, entered into in connection with the LME, and made between the Bank, The Co-operative Group and The Co-operative Banking Group, under which certain rights to nominate Directors to the Board were also granted to certain former bondholders who were purchasers under the purchase agreement.

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

No person may be appointed as a Director under the Shareholder Rights Agreement unless that person has been approved by the Bank's Nomination Committee (including consideration of references and standard background checks), such approval not to be unreasonably withheld. A Director under the Shareholder Rights Agreement will also not be appointed until all required regulatory approvals in respect of that individual have been obtained. Each person appointed as a Director under the Shareholder Rights Agreement shall owe the same fiduciary and other duties as are owed by the other Directors to the Bank.

The Shareholder Rights Agreement does not affect the existing Director appointment rights under the Relationship Agreement but the parties to the Shareholder Rights Agreement have agreed to seek the consent of the purchasers under the Purchase Agreement (two of which are Silver Point and Perry Capital) to vary certain provisions of the Relationship Agreement, including such that only persons that can be properly considered by the Board on appointment to be independent Directors may be appointed by former bondholders under the Relationship Agreement, to extend the time period during which such Directors can be appointed by former bondholders and to ensure that such Director appointment rights continue beyond termination of the Relationship Agreement. The Committed Shareholders agree not to take or omit to take certain actions which may affect the independence of those Directors.

The Directors appointed by the Committed Shareholders under the Shareholder Rights Agreement may be, but are not required to be independent. The Board has discretion to determine whether any Director is independent for these purposes by reference to the UK Corporate Governance Code.

Corporate Governance report continued

Only Directors appointed under the Shareholder Rights Agreement who have been determined by the Board to be independent may be appointed to the Board's Audit and Remuneration Committees. If no Director appointed under the Shareholder Rights Agreement is determined by the Board to be independent, at least one of the Directors appointed under the Relationship Agreement (if they are independent) shall serve on the Audit Committee and the Remuneration Committee. Those Directors may only serve on the Audit Committee if they are considered by the Audit Committee, acting reasonably, to be financially literate.

The Shareholder Rights Agreement provides that at least one Director appointed under the Shareholder Rights Agreement will serve on each of the Risk Committee and the Nomination Committee (Silver Point and Perry Capital will have the right in the first instance to determine which Director appointed under the Shareholder Rights Agreement will serve on which Committee but, in the absence of agreement between them, the Board will decide). This is subject to an overriding requirement that a majority of the members on those Committees must at all times be independent Directors.

Pursuant to the Shareholder Rights Agreement, the Bank has agreed to establish a sub-committee of the Board to assess the feasibility of the Bank listing its ordinary shares on the Official List and make recommendations to the Board with regards to the timing of such a listing. That sub-committee will be comprised of four Directors, being one Director appointed pursuant to the Relationship Agreement, one Director appointed pursuant to the Shareholder Rights Agreement, one Executive Director and one independent Non-Executive Director who is not a Director appointed pursuant to the Relationship Agreement or the Shareholder Rights Agreement.

In addition, any of the Committed Shareholders and The Co-operative Group who together hold 25% or more of the Bank's issued ordinary share capital, will have the right, to require the Bank to assist in the launch of a secondary offering of ordinary Shares, provided that the exercising Shareholders have omitted to sell ordinary shares valued at not less than £100 million. The Committed Shareholders may only exercise this right once in any 12 month period and three times in total. Upon exercise of this right, the Bank would then be required to co-operate with the relevant Committed Shareholders and The Co-operative Group (if applicable) to consummate such a secondary offering, but the launch of any secondary offering would be subject to Board approval of the documentation and certain other specified matters relating to that secondary offering. All fees and costs of any secondary offering must be pre-approved by the 25% shareholders and will be paid by the selling shareholders participating in any such offering out of the proceeds of the secondary offering.

The rights of each Committed Shareholder, and the rights of The Co-operative Group, under the Shareholder Rights Agreement will terminate when it no longer controls, directly or indirectly, the exercise of, in aggregate, 5% or more of the rights to vote exercisable at a general meeting of the Bank.

Appointment and replacement of Directors

The Directors retire from office at each Annual General Meeting. A retiring Director is eligible for re-election. The Nomination Committee is responsible for considering and making recommendations to the Board in respect of appointments to the Board.

Powers of the Directors

The powers of the Directors are determined by the Companies Act 2006 and the Bank's Articles of Association.

Powers of the Board

The Board may exercise all the powers of the Bank to:

- pay pensions or other benefits to any Director or employee;
- establish participation in any profit-sharing or incentive scheme; and
- support and subscribe to any institution or association which may be for the benefit of the Bank, its Directors or employees, and subscribe to any charitable or public object.

Subject to the provisions of the Bank's Articles of Association and the Relationship Agreement the Bank may exercise the powers conferred by the applicable statutory provisions to:

- increase its share capital by allotting new shares;
- reduce its share capital, any capital redemption reserve and any share premium account;
- subdivide or consolidate and divide all or any of its share capital;
- re-denominate all or any of its shares and reduce its share capital in connection with such redenomination;
- issue redeemable shares; and
- purchase all or any of its own shares including any redeemable shares.

The Bank may pass an ordinary resolution authorising the Board to allot shares in the Bank or to grant rights to subscribe for or to convert any security into shares.

The Relationship Agreement and the rights of the preference shares owned by the Co-operative Group Limited contain various provisions that may limit the Bank's ability to issue or allot shares, other equity securities or any securities convertible into, or exchangeable for, or grant any right to subscribe for, shares or other equity securities, without the consent of the Co-operative Group Limited.

Further details on voting rights can be found on page 65 – Statutory Disclosures Information.

Board Committees

The Board has established Board Committees, namely, the Audit Committee, the Risk Committee, the Values and Ethics Committee, the Nomination Committee, and the Remuneration Committee.

All Board Committees have terms of reference describing the authority delegated to it by the Board. Each of these Committees has a role in ensuring the effective oversight by the Board of the Bank and its subsidiaries. The terms of reference for the Audit Committee, Risk Committee, Values and Ethics Committee, Nomination Committee and Remuneration Committee can be found at http://www.co-operativebank.co.uk/aboutus/governance/terms-of-reference-for-Board-Committees.

The Board receives 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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Risk Committee	**57**
Nomination Committee	**60**
Values and Ethics Committee	**62**
Remuneration Committee	**67**

Special purpose committees

During 2014 the Board established two special purpose Committees in order to fulfil a particular operational output required by the Board or to support obligations arising from agreements that the Company has with certain shareholders.

Chairman Selection Committee

In May 2014, the Board announced that Richard Pym would stand down as the Chairman of the Board in the second half of 2014. The Board established the Chairman Selection Committee for the purpose of identifying and nominating, for the approval of the Board, a preferred candidate to succeed Richard Pym as Chair of the Board.

Richard Coates was appointed Chairman of the Committee. During its period of office, the Committee met on four occasions and the Committee Chairman held additional update meetings by telephone with its advisors. The Committee carried out a robust process to prepare the specification for the role of Chair, including the time commitment expected; the selection of a suitably experienced search firm (Korn Ferry) to lead on the selection mandate; and the identification of candidate long and short lists. Richard Pym and Dennis Holt did not participate in the Committee meetings and recused themselves from Board meetings at which the Committee updated the Board on its activities and progress. The Committee made recommendations to the Board on the appointment of the interim successor to Richard Pym and the permanent appointment of Dennis Holt as Chairman of the Board.

Initial Public Offering Committee

As described earlier in this report the Shareholder Rights Agreement required the Board to establish a Board Committee to assess the feasibility of the Company listing its ordinary shares on the Official List and make recommendations to the Board with regards to the timing of such a listing.

Whilst it has not been possible to convene this Committee with the membership specified by the Shareholder Rights Agreement as no Director has yet been appointed pursuant to the Shareholder Rights Agreement, the Board established the Initial Public Offering Committee and agreed that until such times as there was a member of the Board appointed pursuant to the Shareholder Rights Agreement the Committee membership would be comprised of the current Chairman, Chief Executive Officer and a Non-Executive Director nominated under the terms of the Relationship Agreement. Since 30 September 2014, the Committee has met twice. The Board intends that the Committee membership will reflect the terms of the Shareholder Rights Agreement as soon as there are Board members appointed pursuant to its terms to be able to act.

Audit Committee report

Introduction by Audit Committee Chairman

"The Audit Committee provided significant oversight and challenge, and sought assurance over, improvements to the financial reporting process, the execution of the turnaround and monitoring progress over the ongoing roll out of the Risk Management Framework across the day-to-day operations of the Bank. In the first half of the year the Committee recommended Ernst & Young LLP as external auditors to the Bank which was approved by Shareholders at the 2014 AGM. I would like to thank past and current members of the Committee for their significant support and contribution in what has been another very challenging year."

Richard Coates
Audit Committee Chairman
26 March 2015

Purpose of the Audit Committee

To monitor, review and report to the Board on the formal arrangements established by the Board in respect of the financial and narrative reporting of the Bank, the internal controls and the Risk Management Framework, the internal audit and the external audit processes.

Audit Committee membership	Date of appointment	Date of resignation
Richard Coates	Appointed 16 January 2013 Chairman since 9 April 2013	
Graeme Hardie	Appointed 30 August 2013	
Dennis Holt	Appointed 30 May 2014	Resigned 9 December 2014
Derek Weir	Appointed 9 December 2014	
Merlyn Lowther		Resigned 30 May 2014
Anne Gunther		Resigned 29 January 2014

During the year the Committee membership changed with the appointment of Dennis Holt on 30 May 2014 and Derek Weir on 9 December 2014. Dennis Holt remained on the Audit Committee for a short period in the fourth quarter to support a handover during Derek Weir's appointment to the Committee and then retired as a member of the Audit Committee as the role of Chairman is not eligible for membership of the Audit Committee. Meetings of the Committee are generally attended by the Finance Director, invited members of the finance and risk teams and the Director of Internal Audit, none of whom attend as of right. The external auditor attends Committee meetings and private meetings are held with internal and external auditors as necessary to afford them the opportunity of discussions without the presence of management. The Committee met 14 times during the financial year. The Chairman of the Committee reports back to the Board on the outcomes 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 Chairman of each of the Audit and Risk Committees are members of both Committees. Both the Audit Committee and Risk Committee welcome attendance by representatives of the Internal Audit function and external auditor at their meeting.

Audit Committee report continued

Principal responsibilities of the Audit Committee	Key areas discussed and reviewed by the Committee in 2014 include
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 Bank's performance, business model and strategy. • Monitor the integrity of the financial statements of the Bank. • Review and challenge where necessary: – the consistency of, and any changes to, significant accounting policies both on a year on year basis and across the Bank; – the methods used to account for significant or unusual transactions where different approaches are possible; – whether the Bank has followed appropriate accounting standards and made appropriate estimates and judgements, taking into account the views of the external auditor; and – the clarity and completeness of disclosure in the Bank's financial reports and the context in which statements are made. • Reviewing and reporting to the Board on significant financial reporting issues and judgements, including matters communicated to it by the auditor.	• The Committee allocates a number of meetings in its calendar to focus on the preparation for and review of the Interim and the Annual Report and Accounts. During 2014 the review process included a detailed review of significant accounting judgements and accounting policies and regular dialogue with Ernst & Young LLP following its appointment as the Company's auditor at the 2014 AGM. • The Board receives a report from the Audit Committee prior to the Board considering the content of Interim or Annual Reports. • Key judgements discussed as part of the 2014 accounts process are detailed on pages 154 to 173. • Impact of future reporting standards, including IFRS 9 (Financial Instruments).
Internal controls and risk management systems • Review the adequacy and effectiveness of the Bank's internal financial controls and internal control and risk management systems and statements in the annual report concerning internal controls and risk management.	• During 2014 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 CRO attended Audit Committee meetings during the year. • The Committee considered reports of fraudulent activity and other major breakdowns in controls.
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 the function has the necessary resources and access to information to enable it to fulfil its mandate, 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 Board Chairman and to the Committee Chair, and is accountable to the Committee. • Review and assess the annual internal audit work plan and the reasons for any significant change or delay to this plan. • 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. • Monitor and review the effectiveness of the Bank's internal audit function, in the context of the Bank's overall risk management system.	• During 2014 the Committee considered the effectiveness and resourcing requirements of the Internal Audit function. • During 2014, the Committee reviewed and challenged the Internal Audit Charter 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.

Audit Committee report continued

<table>
<tr><th>Principal responsibilities of the Audit Committee</th><th>Key areas discussed and reviewed by the Committee in 2014 include</th></tr>
<tr><td>

External audit
• Consider and make recommendations to the Board, to be put to shareholders for approval at the AGM, in relation to the appointment, re-appointment and removal of the external auditor.
• Ensure that at least once every 10 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 auditor and review the findings of the audit with the external auditor.
• 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.
• Develop and implement policy on the supply of non-audit services by the external auditor.</td><td>• The Committee considered the process for identifying and recommending the appointment of a new external auditor. The appointment of Ernst & Young LLP was approved by shareholders at the 2014 AGM.
• The Committee engaged fully with the external auditor on all of the key judgements.
• The Committee reviewed the external audit strategy.
• 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 auditor.
• The Committee considered the external auditor's management letter containing observations arising from the annual and interim audits leading to recommendations for control or financial reporting improvement.
• The Committee considered the policy and reporting on non-audit fees.</td></tr>
<tr><td>Whistleblowing, bribery prevention and anti-money laundering/terrorist financing
• Review the adequacy and security of the Bank's arrangements for its employees and contractors to raise concerns, in confidence, about possible wrongdoing in financial reporting or other matters and recommend the Bank's Whistleblowing Policy to the Board.
• Review the adequacy and effectiveness of the Bank's systems and procedures for the prevention of bribery and recommend the Bribery Prevention Policy to the Board.
• Review regular reports from the Money Laundering Reporting Officer and the adequacy and effectiveness of the Bank's anti-money laundering and counter terrorist financing systems and controls.
• Review the Committees' Terms of Reference and monitor its execution.</td><td>• Reviewed reported whistleblowing incidents and policy.
• The Committee considered reporting from the Money Laundering Reporting Officer during the year.</td></tr>
</table>

Significant accounting matters

During the year the Committee considered the following significant accounting issues, matters and judgements in relation to the Bank's half year and full year 2014 financial statements as well as the disclosure and presentation of those areas in the Annual Report and Accounts. These were discussed and debated with management and the external auditor (Ernst & Young LLP). Significant accounting matters in the earlier part of the year were discussed with management and the previous external auditor (KPMG Audit Plc).

A number of prior period adjustments were discussed by the Committee and have been accounted for in the year. A summary of these is found below and more details of these can be found in note 3.

Going Concern

There continues to be a material uncertainty around the Going Concern position of the Bank and this was considered in detail by the Committee. The continuing operation of the Bank and the Company is dependent on successfully funding their respective balance sheets and maintaining adequate levels of capital. In order to satisfy themselves that the Bank and the Company have adequate resources to continue to operate for the foreseeable future, the Committee evaluated a number of factors including capital position, liquidity, profitability and forecasts. The Committee considered the position in light of the stage of completion of the Bank's turnaround and the revised plan.

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 and discussion with the PRA. A revised plan was accepted by the PRA following the Bank of England stress tests in December 2014.

The Committee considered and accepted the Going Concern disclosures prepared by management which forms part of note 1 to these financial statements.

Deferred tax assets

The Committee deliberated and challenged the recognition of a deferred tax asset (DTA), the key judgement being the Bank's ability to recover the DTA based on forecasts of future taxable profits. The Committee concluded that, in line with the 2013 financial statements, DTA would not be recognised in the Company accounts in 2014. Following discussion, the Committee concluded that a number of milestones would need to be reached in order for a DTA to be recognised in the future including proven execution of key elements of the Bank's revised plan.

The Committee separately considered DTA recognition in subsidiary companies, the judgement being whether a DTA should be correctly recognised in 100% owned subsidiary companies of the Bank which are currently generating taxable profits. The Committee agreed with management that the correct accounting treatment would be to recognise a DTA in both 2013 and 2014 subsidiary accounts and that these assets should be consolidated into the accounts of the Bank. This represents a prior period adjustment.

Impairment of loans and advances to customers

The Audit Committee reviewed detailed papers prepared by management covering the drivers of changes to impairment provisions including inter alia the emergence period and probability of default, governance and controls over the provisions and substantive evidence supporting model parameters. In terms of the corporate collective provision the Committee reviewed and challenged the methodology and supporting data analysis in respect of probabilities of default, loss emergence periods and management overlays to model outputs. The Committee carefully considered evidence in the post balance sheet period as to whether additional provisions were required relative to conditions existing at the balance sheet.

Pensions

The Committee debated the accounting treatment of both of the Bank's principal pension schemes, Pace and Britannia. It concluded that, as at 2013 year end, insufficient information was available to properly account for the Pace scheme as a defined benefit scheme. However, since agreement had been reached on short term funding of the deficit, the Committee agreed that that liability should be reflected on the balance sheet.

The Britannia pension scheme is a CFSMS owned scheme, guaranteed by the Bank. The Committee considered whether further separation from The Co-operative Group and the TUPE of the majority of the affected staff to the Bank, would result in the pension scheme being accounted for in the books of the Bank in 2014. The Committee concurred with management that, in 2014, the Britannia scheme be accounted for on the Bank's balance sheet.

Conduct risk and legal provisioning

The Committee discussed each provision including recognition, completeness, levels of provisioning and associated disclosures.

The Audit Committee reviewed recommendations from management that further provisions should be taken in respect of a number of conduct risks including Packaged Accounts, Affinion and Collective Conduct Risk. Key assumptions included population affected, size of potential redress and customer response rates. Detailed papers were presented setting out the underlying assumptions and these were debated and challenged by the Committee.

During 2013, breaches of the technical requirements of the Consumer Credit Act (CCA) were identified resulting in the Bank not being legally entitled to the interest on the loans subject to a breach. The Bank anticipates redressing customers during 2015. The Committee discussed these matters in respect of the 2014 Financial Statements and concluded that there would be no recognition of this interest income in respect of the 2014 full year. Whilst there was no impact on the loss for the year, prior year comparatives were re-presented as described in note 3.

Business separation

In line with 2013, the Committee debated the requirement for a separation provision and concluded that the Bank was obligated to separate from The Co-operative Group and that a separation provision was required. The Committee considered a report from management detailing the quantum of the provision. The key judgements centred around what spend was necessary to effect separation and what was considered betterment and therefore not allowable as a provision.

FSCS levies

During 2014 the Committee considered IFRIC 21 (Levies) which provides interpretation on the date on which the obligation to pay the FSCS levies arises being the date on which the levy period begins, 1 April 2014. The Committee concluded that the Bank should no longer recognise a provision for two levy years, which resulted in a restatement of prior year comparatives in the 2014 accounts.

Fair Value Adjustments (FVA) and unwinds

When the Bank merged with Britannia Building Society in 2009, the assets and liabilities of Britannia were brought onto the balance sheet of the Bank at estimated fair value. The Committee considered all fair value balances remaining on the Bank's balance sheet at the end of the year and the associated unwind profiles. In particular, the Committee discussed the detailed calculation and substantiation of the interest fair value adjustment on corporate and housing association loans. It concluded that the unwind profile on the corporate loans should have been shortened at the end of 2013 to take account of the deleverage strategy and that a prior year adjustment should be booked to better reflect the remaining behavioural life of the asset. This resulted in a prior period adjustment to the Bank's accounts.

EIR

The Committee considered a presentation by management discussing a review of EIR modelling in the Bank. In particular the Committee discussed the historic calculation and the assumptions used and concluded that a prior year adjustment was necessary to correct the EIR balances. The key judgement centred on the assumptions on interest rates and behavioural lives used in the model. This resulted in a prior period adjustment to the Bank's accounts.

Hedge accounting

The Committee reviewed the Bank's approach to hedge accounting. This included reviewing the different types of hedging entered into by the Bank, valuation techniques and hedge ineffectiveness. The Committee agreed with management that a prior year adjustment was necessary, amending comparative information to reflect the revised interpretation of hedge ineffectiveness accounting which was reflected in the Interim Financial Review 2014.

Unadjusted errors

The external auditor reported to the Committee the misstatements that they had found in the course of their work, including in respect of prior years, and no material amounts remain unadjusted.

Fair, balanced and understandable

The Committee considered whether the 2014 ARA were 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 Audit Committee held to review and consider the ARA in advance of approval by the Board.

Tender of Audit

In 2014, management proposed tendering the audit of the Bank in line with best practice. The Committee debated the timing of such a decision and agreed with management that, considering the forty year tenure of the incumbent auditors (KPMG) and the overall position of the Bank, that a fresh pair of eyes would be in the best interests of the Bank.

EY has performed a detailed, risk based audit of the Bank, including opening balances and the Committee has discussed and debated the ensuing prior period adjustments with management and EY.

External audit and the appointment of Ernst & Young LLP as the Company's auditor

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

In connection with auditor rotation and KPMG Audit Plc's tenure as the Company auditor for around 40 years, the Board, on the recommendation of the Committee, decided in early 2014 to tender the audit. KPMG did not take part in the audit tender process. Ernst & Young LLP was successful having been considered by the Audit Committee to meet the criteria for appointment having satisfied itself that EY had the expertise and capacity to perform the audit to the standards required. The Board approved and recommended to shareholders the proposal that Ernst & Young LLP be appointed as the Company's auditor. The resolution to appoint Ernst & Young LLP was passed at the AGM on 30 May 2014 and KPMG stood down and their appointment ceased at the conclusion of that AGM. Following their appointment Ernst & Young LLP acted as the external auditors to The Co-operative Bank plc for the remainder of 2014.

The 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 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 a detailed understanding of the Bank is necessary. Management regularly provides the Committee with reports on audit, audit-related and non-audit expenditure, together with proposals of any significant non-audit related assignments.

The Committee reviews and, where necessary, challenges management to ensure auditor objectivity and independence is not impaired. Fees for audit-related and non-audit services incurred during the year amounted to £2.7m (2013: £4.5m). Details of the fees paid for audit services, audit-related services and non-audit services can be found in note 5 to the financial statements. The Committee is satisfied that the overall levels of audit-related and non-audit fees are 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.

Audit Committee report continued

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

- the external auditor's progress achieved against the agreed audit plan and communication of any changes to the plan, including changes in perceived audit risks;
- the competence with which the external auditor handled the key accounting and audit judgements and communication of the same with management and the Committee;
- the external auditor's compliance with relevant regulatory, ethical and professional guidance on the rotation of partners;
- 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 Ernst & Young LLP.

The Audit Committee is also responsible for ensuring that, at least every 10 years, the audit services contract is put out to tender (the last tender being in 2014). As the appointment of Ernst & Young LLP was made on 30 May 2014, there have been no matters concerning audit partner or senior audit staff rotations to consider.

Internal controls

Where material risks have been identified, the Bank has instigated action to strengthen its systems of internal control to mitigate these risks. The Board is ultimately responsible for the Bank's 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. 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 Committee uses information drawn from a number of different sources 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 Committee.
- An annual review of the Bank's systems of internal control was undertaken by the Committee and facilitated by the Risk Function.
- Further objective assurance is provided by external specialists.

Turnbull review of effectiveness of internal control

In line with the UK Corporate Governance Code and the supporting 'Turnbull' guidance, the Directors confirm they have carried out an assessment of the principal risks facing the Bank and have undertaken a review of the effectiveness of internal control. The assessment approach was aligned to an assessment of the Bank's overarching Risk Management Framework (RMF) and the effectiveness of the constituent control frameworks designed to manage the Bank's Principal Risks. The review covered all material controls, including financial, operational and compliance controls and risk management systems. The Bank's control environment and RMF remain underdeveloped in a number of areas. The key conclusions of these reviews were as follows:

- As described in the Annual Report and Accounts, through deployment of the RMF the Bank has determined its principal risks and the level of acceptable risks, as stipulated in the Bank's risk appetite statement. There is sufficient risk management to ensure that levels of capital and liquidity held are consistent with the risk profile of the business. This assessment is dependent on a large number of manual controls and the use of financial spreadsheets.
- Changes continue to be made to ensure the Bank remains on track with its revised plan and tactical remediation to build resilience including key focus on capital strengthening. Limited improvements were made in financial, operational performance and capital position in 2014. Further areas of improvement were also made around governance, interconnecting activities, forecasting, stress testing and control frameworks. However, the control environment remains an area of key concern.
- Work is ongoing in respect of the RMF including reporting of risk appetite and exceptions. A review of the effectiveness of the RMF in the last quarter of 2014 has shown that there are some areas of weakness in embedding and gaps in accountability. Developments are underway to progress this to ensure an effective Bank-wide governance model with full responsibility and accountability is implemented.

Audit Committee report continued

- Revised values have been rolled out to all staff, however retention of existing and resourcing of new staff continues to be challenging. To build up capability and support the simplification and growth strategy of the Bank, there is continued focus on embedding a strong risk culture and setting and managing risk appetite with appropriate levels of risk acceptance. In light of the many challenges facing the Bank, the risk to the plan over the next five years should not be underestimated.
- Substantial work took place in 2014 to define and implement required controls to comply with growing complexity of regulatory changes. The Bank now needs to ensure ongoing resilience to meet compliance. Significant investment in resources to address the various breaches of the technical requirements of the CCA and mortgage lending, and the associated remediation work, has also continued.
- Improvement in the culture of operational risk and a more robust control framework through the implementation and further embedding of the RCSA methodology, toolset and risk event process has been substantiated through testing. Further work is required in this area.
- Model Risk is a key area for the Bank. Many of the processes are manual and require significant complex modelling. This includes many of the models that contribute to the numbers in the Bank's financial statements. Development of the model risk framework is behind target and there is a requirement to ensure the Bank can attest to its Internal Ratings Based status and Capital Requirements Regulation (CCR). A strategic project has been established to improve governance of model risk and the wider CRR.
- The Bank's legacy IT infrastructure remains a key focus with the migration for IT Enterprise Services to IBM to address Disaster Recovery and Resilience issues. Remediation plans are targeted to risk reduction and to move all Technology Key Risk Indicators to within appetite, with refinement of key controls. However, the project carries significant execution risk where the control environment remains weak.
- There was a considerable reduction of open and overdue audit actions in 2014 as a result of increased Executive attention. Internal Audit, supported by both the Executive and Board Committees, will continue to focus on timely resolution of audit issues with accountability for missed deadlines reported to the Executive.
- The Committee discussed and accepted the risk of the manual nature of the financial statements close process. A project is in place to address this risk, with a phased implementation beginning in 2015.

After reviewing the presentations and reports from management and consulting, where necessary, with the external auditor, the Committee was satisfied that the financial statements appropriately addressed the critical judgements and key estimates (both in respect of the amounts reported and the disclosures). The Committee was also satisfied that the significant assumptions used for determining the value of assets and liabilities had been appropriately scrutinised and challenged.

Internal Audit

The Bank has an Internal Audit department comprising 20 in-house auditors supported by an Internal Audit co-source arrangement with Deloitte LLP, PwC LLP and Grant Thornton UK LLP. The co-source arrangement, which has been in place for a number of years, supports the Bank's requirements for specialist skills or additional resource where it would be inefficient to resource internally. Independence of the internal audit function is supported by the Internal Audit Director reporting jointly to the Chairman of the Audit Committee and 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 Bank's Risk Management Framework. The audit plan is aligned to the business' strategic plan and also covers mandatory requirements from relevant regulators.

During 2014 the scheduled internal audit reporting activity addressed a cross section of the Bank's key operations and internal control mechanisms. A total of 41 internal audit reports were delivered during 2014 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 Internal Audit plan remains based upon a quarterly planning cycle which continues to give flexibility on the type of assurance provided, aligned to the risk profile of the Bank which will develop with the progress of the Bank's turnaround.

Internal audit reports are reviewed in conjunction with operational and line management and then by ExCo and other Board Committees as appropriate.

Audit findings and the related management actions are tracked to completion by Internal Audit. Where audit issues are overdue these are reported to ExCo and the Audit Committee and escalated as appropriate. The Committee is provided with reports on material findings and recommendations and regular updates on the progress made by management in addressing the findings. All action points are recorded on a bank-wide database to facilitate tracking and reporting.

Presentation of Internal Audit reports to the Audit Committee or when required other Board Committees includes attendance by the Executive Committee members and senior managers responsible to explain the activities underway to address any actual or potential weaknesses identified.

The audit plan is approved by the Audit Committee, and shared with the regulator, quarterly.

Risk Committee report

Introduction by Risk Committee Chairman

"Our role remains one of ensuring rigorous challenge and debate of the Bank's key risks, challenging management on strategic decisions and the Plan. Driving accountability amongst the senior management team and throughout the organisation supports risk management as a continuous process. Our focus in 2014 has been monitoring against the approved risk appetite and the embedding of the revised Risk Management Framework. The Bank continues to face significant risks which could impact its ability to implement its plan."

Graeme Hardie
Risk Committee Chairman
26 March 2015

Purpose of the Risk Committee

To review and report its conclusions to the Board on the Bank's risk appetite and Risk Management Framework, taking a forward looking perspective and anticipating changes in business conditions.

Risk Committee membership[1]	Date of appointment	Date of resignation
Graeme Hardie (Chairman)	Appointed 21 August 2013	
Richard Coates	Appointed 21 August 2013	
William Thomas	Appointed 1 January 2014	
Derek Weir	Appointed 30 September 2014	
Merlyn Lowther		Resigned 30 May 2014
Anne Gunther		Resigned 30 May 2014

1. Niall Booker attended as a member over the period from May 2014 to February 2015 but is not shown in the table above as only non-executives should be counted as members of the Risk Committee. During this period the other members were all non-executive and no matters were formally put to the vote. Going forward, Niall Booker, as CEO, will continue to be able to attend the Committee, but not as a member.

The Risk Committee met in total 10 times during the financial year. In performing its duties, the Committee has access to the services of the Chief Risk Officer, the Chief Executive Officer, the Finance Director, and the Director of Internal Audit as well as external professional advisors. To support the interplay between the role of the Risk Committee and the Audit Committee, the Chairman of the Audit Committee is a member of the Risk Committee.

During 2014 the risk management structure was overhauled alongside the roll out of the cultural transformation programme across the Bank. The continued embedding of the Risk Management Framework is a key component in the transformation of culture in the organisation. The Committee has focused throughout the year on the execution of the turnaround and worked closely with the Audit Committee to monitor risk management and internal controls.

The Bank has determined its principal risks, and the level of acceptable risks, as stipulated in the Bank's risk appetite statement, which aims to ensure that there is an adequate system of risk management and that the level of capital and liquidity held are consistent with the risk profile of the business. The Bank's exposure to credit and other risk types such as market, liquidity, operational, pension, reputational and other risks that are inherent to our industry such as strategy, product range and geographical coverage and the processes for managing those risks are described in detail on pages 95 to 130. The principal risks and uncertainties which the Bank faces are described on pages 26 to 32.

Risk Committee report continued

The Committee has focused throughout the year on the range of risks the business is facing, on the execution of the turnaround and worked closely with the Audit Committee to monitor risk management and internal controls.

Principal responsibilities of the Board Risk Committee	Key areas discussed and reviewed by the Committee in 2014 include
Risk Management Framework • Review and challenge the design and implementation of the Risk Management Framework and recommend to the Board for approval. • At least annually, review the quality and effectiveness of the Risk Management Framework and the Risk Management Framework Policy. • 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; – adequate independence, being free from management or other restrictions; and – review the capability of the Bank to identify, assess, and manage new risk types.	• During 2014, the Committee discussed the various challenges which the Bank faced in embedding the Risk Management Framework across the organisation. Such challenges were set against the wider context of the Bank's overall risk profile and risk appetite. The successful embedding of a Risk Management Framework is dependent upon the Bank being able to improve the quality of Risk Culture across the organisation and to instil a strong three lines of defence operating model – a model which is generally standard across the industry. • To embed a sound risk culture, the Bank must resource the appropriate level of suitably skilled people in Risk and across the Bank. The Committee called for the CRO and the HR Director to provide regular reporting on people risk, on breaches to regulation and policy and breaches on operational controls as well as wider HR challenges. • The Committee has regularly reviewed the Bank's preparedness to meet increasing regulatory and operational risk.
Risk culture • Review, promote and challenge the Bank's 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, regular reports were provided by the CRO on the main risks which the Bank faces. A principal focus of the Committee was to monitor activities being undertaken by the HR Director and by the CRO on risk culture. This culminated in early 2015 with the Committee (through the CRO) providing to the Remuneration Committee risk weightings to be applied to executive remuneration structures and on malus and clawback obligations. • The Chairman of the Risk Committee is a member of the Remuneration Committee. The CRO 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 risk appetite, risk measures, risk tolerance and risk 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 ILAA.	• The Committee considered at each meeting reports and findings in relation to customer conduct matters and regulatory risk. On these matters (as on other matters), the Committee was engaged with Management to ensure that appropriate steps were being taken to redress issues where customers were potentially facing or had suffered detriment as a result of previous operational shortcomings. The Committee regularly reviewed the development of plans to improve regulatory compliance. • During the year, the Committee has worked with the CRO to improve 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. • Prior to recommending to the Board for approval, the Committee reviewed all material submissions to be provided to regulatory bodies. Such reviews included ICAAP, ILAA and CPP stress tests. • The Committee has also engaged in extensive monitoring and oversight of the various remediation programmes currently under way across the Bank, including IT, mortgages and CCA.

Risk Committee report continued

Principal responsibilities of the Board Risk Committee	Key areas discussed and reviewed by the Committee in 2014 include
Business strategy • Provide detailed review and challenge of proposed business strategy giving consideration to the impact on the Bank's 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 2014, discussed and monitored the principal risks and uncertainties that faced the Bank. The Committee reviewed the plans under consideration to determine if they were sufficiently robust and practical. • The Committee undertook a number of reviews of IT's plans for remediation, for a migration of key applications on to IBM infrastructure and for separation of key services away from The Co-operative Group. In addition, the Committee also reviewed the risks associated with outsourcing a number of key services to third party suppliers.
Risk monitoring • Consider, oversee and advise the Board on, and provide challenge on the Bank's exposure to, all significant 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. • Review reports on any material breaches of risk limits and the adequacy of proposed action. • Consider risks posed to the Bank 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.	• During 2014 the Committee continued to consider and monitor organisational decision making and judgements and customer outcomes. • As a principal risk is the extension of credit to customers, the Committee considers credit risk data and key indices at each meeting. • 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. • The Committee has considered reporting of emerging risk during the year together with regulatory feedback given to the Bank by the PRA and the FCA and the plans of both regulators published to the market from time to time.
Regulatory risks and Compliance • Review and approve the annual regulatory monitoring 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 Compliance Officer and keep under review the adequacy and effectiveness of the Bank's compliance function.	• The Committee has challenged the development of certain risk models to support the attestation of and compliance with the Capital Requirements Regulation (CRR).
Risk reporting • Receive reports, findings and recommendations from the Executive Risk 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 CRO, the Committee continued to have access to the findings and recommendations of the ERC 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 and interim reporting.
Chief Risk Officer • Recommend to the Board the appointment and/or removal of the Chief Risk Officer. • Review the resignation of the Chief Risk Officer and make a recommendation to the Board about its acceptance. • Meet at least once a year with the Chief Risk Officer without the presence of management.	• The Committee considered regulatory monitoring plans during the year. • The Compliance Officer attended Risk Committee meetings during the year providing regular reporting and analysis. • The Committee provided their input to the Nomination Committee as part of the process to determine the appointment of a CRO during 2014.

Nomination Committee report

Introduction by Nomination Committee Chairman

"During 2014 the main focus of the Nomination Committee continued to be the strengthening of the Board through new appointments to meet the current and developing needs of the business and reflect the regulatory framework in which the business operates; the appointment of senior executives and consideration of the appropriate timing and structure of a Board effectiveness review during a period of change in Board composition."

Dennis Holt
Nomination Committee Chairman (appointed 1 October 2014)
26 March 2015

Purpose of the Nomination Committee

To review and make recommendations on the Board 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 since 1 October 2014)	Appointed 25 February 2014	
Maureen Laurie	Appointed 30 June 2014	
William Thomas	Appointed 30 May 2014	
Richard Pym (Chair)		Resigned 1 October 2014
Richard Coates		Resigned 30 May 2014
Graeme Hardie		Resigned 30 May 2014

During 2014 the Nomination Committee considered appointments of Non-Executive and Executive Directors to the Board and key Executive appointments. The Bank engaged external search consultancy JCA Group during 2014 to assist in the search for Non-Executive Directors and for appointments in 2015 has engaged MWM Consulting. Korn Ferry acted during 2014 in respect of the selection of a Chairman. Spencer Stuart and Skills Capital have been retained by those shareholders (other than The Co-operative Group Limited) which may nominate Non-Executive Directors under the Relationship Agreement and the Shareholder Rights Agreement (details of which can be found within this report). JCA Group, MWM Consulting, Spencer Stuart, Korn Ferry and Skills Capital do not have any connection with the Bank.

During 2014 the Board agreed that a special purpose Committee rather than the Nomination Committee should lead the search and selection for the role of Chairman following the announcement by Richard Pym that he would leave the Bank that year. A description of the activities of the Chairman Selection Committee can be found on page 49.

During 2014 the Company has been developing its diversity policy across the business. The Nomination Committee has recently considered a policy to promote diversity on the Board in recognition that a diverse Board represents the views of society, brings a wide range of skills and knowledge to the Board and enhances challenge and discussion from a diverse range of viewpoints. The policy includes a target for the representation of the under-represented gender on the Board (currently women). 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 nominated by shareholders, we will continue to encourage those shareholders directly and through the executive search consultancies engaged in the search process, to reflect diversity in the lists of candidates nominated for the consideration of the Board although the ultimate choice of nomination is a matter for the shareholder in question. The Chairman Selection process during 2014 considered diversity amongst other attributes in the review of candidate selection criteria alongside the overarching requirement of appropriate skill set, experience and expertise.

During the year the Company retained gender diversity on the Board following the retirement of two female Directors at the 2014 AGM. At the end of 2014, of the nine Directors on the Bank's Board, two were women (22%). The Board's target for the number of women on its Board is three by the end of 2016.

Nomination Committee report continued

Principal responsibilities of the Nomination Committee	Key areas discussed and reviewed by the Committee in 2014 include
• Identifying and nominating, for the approval of the Board, candidates to fill Board vacancies having regard to the balance of skills, knowledge, independence, experience and diversity on the Board.	• During 2014 the Committee considered a number of nominations at both Board and Senior Executive level. This activity included the role and capability requirements together with the overarching succession plan required for the Board and Senior Executive.
• Consider the description of the role, skills, capabilities and time specification required for a particular appointment and in respect of the Chair and Senior Independent Director.	
• Formulating plans for succession for Directors and Non-Executive Directors and Senior Executives including the re-appointment 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.	
• Keep under review the Bank's policy on diversity, including gender, and the measure of objectives that it has set in implementing the policy, and progress on achieving the objectives.	• The Committee has considered a Board Diversity Policy and will monitor the targets currently set during 2015.
• Membership of the Audit and Remuneration and Risk Committees, and any other Board Committees.	• During the year and as a result of new appointments to the Board and retirements during the year, the Committee considered and made recommendations to the Board on Committee composition across all Board Committees.
• Review the results of the Board performance evaluation including the time required from Non-Executive Directors.	• The Committee considered the scope of an external Board Evaluation which will take place during the course of 2015.
• The election or re-election of Directors by shareholders at the Annual General Meeting.	• The Committee reviewed the positon of Directors offering themselves for election and re-election at the 2014 AGM.

Values and Ethics Committee report

Introduction by Values and Ethics Committee Chair

"I am pleased to present the report of the Bank's Values and Ethics Committee (V&E Committee) and my first as its Chair. 2014 was the Committee's first full year of operation and it has been focused on overseeing the launch of the customer poll and creation and publication of the Bank's new Ethical Policy in January 2015. The Committee provides the Board with a forum for Directors and management to consider issues and opportunities which emerge within the financial services industry and as the Bank embeds the new Ethical Policy."

L. Carstensen

Laura Carstensen
Value and Ethics Committee Chair
26 March 2015

Purpose of the Values and Ethics Committee

To recommend to the Board for its approval and adoption the Co-operative values and Ethical Policies of the Bank and to advise the Board of the Bank's conformity with such values and ethics in its operations and activities.

V&E Committee membership	Date of appointment	Date of resignation
Laura Carstensen (Chair)	Appointed 27 May 2014	
Dennis Holt	Appointed 30 June 2014	
William Thomas	Appointed 13 December 2013	
Maureen Laurie	Appointed 30 June 2014	
Brona McKeown	Appointed 30 June 2014	
Alistair Asher	Appointed 29 January 2014	Resigned 24 March 2014
Richard Pym		Resigned 1 October 2014
Richard Coates		Resigned 30 May 2014
Anne Gunther		Resigned 30 May 2014
Graeme Hardie		Resigned 30 May 2014
Merlyn Lowther		Resigned 30 May 2014

The V&E Committee was constituted on 1 November 2013 demonstrating the Bank's commitment to promoting and conducting its business in accordance with the established values of The Co-operative Movement. Laura Carstensen was appointed as Chair of the V&E Committee on 27 May 2014. The Co-operative Group has the right to appoint one of its appointees to the Committee whilst it indirectly or directly holds 20% or more of the ordinary shares of the Bank. Alistair Asher was the Group's nominee until his resignation on 24 March 2014. The Group has currently chosen not to appoint a member of the Board and hence a member of the V&E Committee.

During 2014 we were encouraged by the continuing support and engagement of our customers. The work of the Committee included the preparation for the Customer Poll, conducted on the Bank's behalf by You Gov and launched during the summer of 2014. Over 74,000 people, the majority of whom are our customers, completed that poll. We were encouraged that some 4% of responses were received from people who were not customers of the Bank at that time and 62% of customers participating in the poll responded that the Ethical Policy was either the only or the main reason why they were customers. The tremendous response rate helped us to reflect interests and issues important to our customers in the shaping of the Ethical Policy. Strong values are what our customers have expected from us since we were established and in 1992, we became the first bank to have a customer led Ethical Policy. The Policy remains unique in UK banking because it is shaped by our customers and embodies the values we share. The Ethical Policy is published on the Bank's website at http://www.co-operativebank.co.uk/aboutus/ourbusiness/ethicalpolicy.

Values and Ethics Committee report continued

The Committee contributed to the process for the Bank's advertising campaigns launched in late 2014. The Committee also considered several initiatives supporting the new Ethical Policy, including potential campaigns and partners and the cultural transformation programmes rolled out during 2014, reviewing material outsource suppliers selected by the Bank and ensuring the Bank's approach to Product Reviews incorporated assessment against the Ethical Policy.

During 2014, the Chair of the Committee together with each of the Chairs of Remuneration and Risk Committees regularly engaged to ensure that there was consideration of the Company's values and ethics proposition in the discussion and reporting of issues at Board and Committee meetings including matters such as product reviews, design processes, and executive remuneration structures.

The Committee has agreed that it will meet more frequently in 2015 than may be required by its terms of reference and particularly as it focuses on a review of the performance of the Bank against the five pillars of the Ethical Policy, namely, ethical banking, ethical products and services, ethical business, ethical workplace and culture and ethical campaigning and as a consequence of its review prepares an annual report for approval by the Board.

The V&E 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 of the Values and Ethics Committee

- Recommends to the Board for approval and adoption the Co-operative values and Ethical Policies of the Bank.
- 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 objectives of the Bank as described in the Articles of Association having regard to:
  - legal and regulatory requirements applicable to the Bank and its Directors;
  - the need for the Bank's operations to be commercially sustainable and profitable; and
  - the desirability of maintaining and enhancing the public reputation and image of the Bank.
- Monitor and report to the Board on:
  - customer satisfaction levels (with a focus on service levels and on products in the light of the Bank's Ethical Policies, in each case assessed by reference to relevant customer metrics);
  - alignment of treatment of the Bank's customers with its values and Ethical Policies;
  - alignment of employee training and culture with its values and Ethical Policies;
  - Corporate Social Responsibility, community investment, environmental and other projects and activities of the Bank;
  - the 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 Bank's values and Ethical Policies;
  - provision of products and services to sectors/organisations with clear social justice or community benefit purpose;
  - the development of products and services with 'ethical' features;
  - the Company's approach to improving the social and environmental impacts of the Bank's own operations; and
  - the choice of suppliers, partners and third party relationships which should be informed by the Bank's 'ethical' policy.

Key areas discussed and reviewed by the Committee in 2014 include

- The Committee considered the structure of the Customer Poll leading to the development and launch of the Ethical Policy in January 2015.
- 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 of the Bank.
- The Committee has considered during its first full year the development of key metrics and reporting data and the following matters:
  - customer service level metrics across the Bank including complaints management;
  - mapping of workplace values to the Bank's and Co-operative values;
  - product review and development processes which embed the Bank's values and ethics and views of stakeholders;
  - assessment of the alignment of potential supplier or outsourcing arrangements with the Bank's Ethical Policies and the associated procurement process; and
  - development of the Bank's activities in respect of community involvement, environmental impact and social responsibility.

Board effectiveness

Performance evaluation

The Board recognises the requirement to undertake a formal and rigorous annual evaluation of its own performance and that of its Committees and individual Directors.

During the 2014 financial year, the Bank did not satisfy the Code provision regarding external evaluation of the Board. The Board last underwent an external evaluation review of its effectiveness at the end of 2010. As there are further appointments to the Board anticipated to be made during 2015 under the terms of the Relationship Agreement and Shareholder Rights Agreement, which are described on page 47 of this Annual report and accounts, the Board has agreed that the external effectiveness review will take place in 2015.

During the year and as a result of the announced departure of Richard Pym and the appointment of Dennis Holt as Chairman on 27 October 2014 the Bank did not comply with principle A 4.2 of the Code as it was impractical to carry out a formal appraisal of the Chairman. The Chairman of the Selection Committee considered the views of the Non-Executive Directors generally as to the role of the Chairman as part of its selection process. The Board considers these events and the processes it used to manage activity will provide additional context to the structure of the external evaluation.

The Directors consider that the development of Board strength and specific skill sets and expertise through Board appointments in 2014 and those anticipated from nominations arising from shareholder agreements will support the Board in its ongoing effectiveness.

The Chairman will carry out individual assessments of Board members, focusing on their skill sets, effective contribution during and outside of Board and Committee meetings and their overall commitment to the role, with each of the Directors on at least an annual basis.

The Chairman is overseeing an internal self-assessment of Board effectiveness. The Directors have been asked for their individual views on the composition and membership of the Board, the way the Board works, the role of Committees and learning and development opportunities. The outcome of the self-assessment will inform the structure of the planned external evaluation exercise and identify enhancements to be made to increase the effectiveness of the Board and its operation.

During 2015, the Directors, led by Richard Coates as the Interim Senior Independent Director, will be responsible for the performance evaluation of the Chairman.

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 Bank, and includes briefing sessions with members of the Executive team and a branch visit.

As part of the Approved Persons' process an individual training plan is designed for each Director which is reviewed periodically. Throughout 2014 the Board continued to hold collective training sessions which are scheduled to take place before Board meetings. On some occasions the scheduled training did not take place and the allocated training sessions were used to consider urgent business issues.

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 the 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 Board as a whole, with a view to developing its effectiveness. He ensures that the Directors' professional development needs are identified and that they are adequately informed about the Bank and their responsibilities as Directors.

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 unless that interest is first authorised by the other Directors. The Bank's Articles of Association allow the Board 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 Board are recorded in the Conflicts of Interest Register which is reviewed by the Board at least annually. The Board considers the Conflicts of Interest Register at each Board meeting and is satisfied that all potential conflicts are appropriately considered and have been approved. The Board has 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.

Prior to taking up any external appointment or responsibilities, Directors are asked to consult with the Company Secretary and the Chairman.

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 Bank or any of its subsidiary undertakings.

No Director had a beneficial interest in any shares in the Bank.

Insurance and indemnities

During 2014 the Bank maintained appropriate Directors' and Officers' liability insurance in respect of legal action against its Directors and Officers. Various officers had, and continue to have, the benefit of indemnities from the Bank 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 2014 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 from time to time professional advice to the Board. There is an agreed procedure by which the Directors may take independent professional advice at the Bank's expense in furtherance of their duties.

Statutory disclosures information

Share capital structure, transfer restrictions and takeover bid related disclosures

As provided in the Bank's Articles of Association, the Bank has two classes of share capital, ordinary shares, representing 88% of the total share capital, and preference shares representing 12% of the total share capital. For information about the ownership of each class of shares, please see the Corporate Governance report – Relations with shareholders on page 45.

Transfer of shares

Shareholders may transfer any shares in any manner which is permitted by law and is from time to time approved by the Board. 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. 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.

In connection with the LME, The Co-operative Group Limited acquired the entire issued amount of the Bank's preference shares, and signed a deed of waiver waiving any rights to income and capital in respect of the preference shares. As holder of the preference shares, The Co-operative Group Limited has the right to speak and vote at a general meeting of the Bank if: (1) its rights are being varied; or (2) the Bank is being wound up or there is other return of capital.

Rights attaching to the preference shares can only be varied by consent of the holder of the preference shares. The Bank's Articles of Association require this consent to be obtained under certain circumstances, including:

- issuances of shares or grants of any rights to subscribe for or to convert shares or other securities into share capital ranking in priority to or pari passu with the preference shares or being capable of being redeemed whilst any of the preference shares are in issue, or the variation of the rights of any class of shares so as to fall within the foregoing; and
- repayments or reductions in the Bank's share capital.

Statement of Directors' responsibilities in respect of the Annual Report and Accounts and the financial statements

The Directors are responsible for preparing the Annual Report and Accounts and 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 (the Company) in accordance with applicable law and regulations.

Company law requires the Directors to prepare Bank and Company financial statements for each financial year. Under that law they have elected to prepare the Bank and the 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 Bank and Company and of their income statement for that year. In preparing each of the Bank and 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 Bank and 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 Bank's and Company's transactions and disclose with reasonable accuracy at any time the financial position of the Bank and 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 Bank and 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 Bank's website. Legislation in the UK governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions. The Directors consider the Annual Report and Accounts and financial statements, taken as a whole, to be fair, balanced and understandable and provide the information necessary for shareholders to assess the Bank and Parent Company's performance, business model and strategy.

Disclosure of information to the Auditor

So far as the Directors are aware, there is no relevant Audit information of which the 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 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 Company and of the undertakings included in the consolidation taken as a whole; and
- the Directors' report includes a fair review of the development and performance of the business and the position of the issuer and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties that they face.

By Order of the Board

Dennis Holt
Chairman
26 March 2015

Directors' Remuneration report

Statement from the Committee Chair

On behalf of the Board, and as Chair of the Bank's Remuneration Committee, I am pleased to present the Directors' Remuneration report for the year ended 31 December 2014. As best practice, the Bank is voluntarily committed to following listed company disclosure regulations where possible and appropriate. Accordingly this report is split into two sections:

- The Directors' Remuneration Policy (Policy), outlining our proposed framework for Executive Directors' remuneration; and
- The Annual Report on Remuneration, which sets out how the policy was implemented in 2014 and how we intend to apply the policy in 2015.

The Policy and the Annual Report on Remuneration will be put forward for shareholder approval by way of two separate advisory votes at the 2015 AGM.

Our proposed remuneration policy

As discussed in last year's report, during 2014 the Committee undertook to develop a remuneration policy for the Bank following its separation from The Co-operative Group. Our objective is to align the interests of Directors with those of shareholders, consistent with the Bank's risk appetite and regulatory environment, paying due regard to the Bank's plan and Ethical Policy.

It is crucial to maintain the link between remuneration, including variable pay, and the achievement of the Bank's commercial objectives. This is especially critical while the Bank is in recovery. The policy we have developed aims to reward short term progress and long-term success, fully incentivising the key objectives of the plan to restore the Bank to health as a sustainable, soundly-capitalised financial institution.

The Committee has taken a collaborative approach in developing the policy, seeking feedback from the Chairs of the Risk, Audit and Values and Ethics Committees of the Board. In this process, we have recognised that our key Executives have been appointed to secure the Bank's future, and that many of the challenges they have been tasked to identify and overcome may date back several years.

A further consideration has been to ensure that the principles set out in the Bank's Ethical Policy remain central to our decisions on pay, and that overall levels of remuneration should be proportionate and fully justified by performance and achievements.

In common with other financial institutions, regulation must remain central to decisions on pay policy, both in its development and application. A key driver in 2014 has been compliance with the Capital Requirements Directive (CRD IV); in particular, the shifts in balance between fixed and variable remuneration towards less leveraged arrangements. In accordance with the Remuneration Code, our shareholders approved in 2014 the flexibility to pay variable remuneration up to twice the amount of fixed remuneration. We have engaged fully with the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA) to design a framework which is strongly aligned to the regulatory regime.

Regulation will continue to evolve, and we have worked towards remuneration arrangements which can be adapted to comply with new rules, if required, and as the Bank progresses from recovery to stability. The Bank will continue to monitor regulatory developments, including the EBA consultation paper requirements released on 4 March 2015, and any other future regulatory changes.

The key features of our proposed remuneration policy are as follows:

- to develop the Annual Incentive Plan (AIP), strengthening its focus on the key short term goals required to support the Bank's turnaround. The AIP will now be subject to deferral requirements for material risk takers, in line with regulatory requirements;
- to introduce a Long Term Incentive Plan (LTIP). Prior to separation, the CEO was eligible to participate in the LTIP of The Co-operative Group. The remaining legacy entitlement from such participation is reflected in the CEO's current remuneration package and these obligations will be fulfilled by the end of 2015. A new LTIP is therefore essential to reward the achievement of financial and strategic goals vital to the recovery of the Bank and, in so doing, build value for our investors; and
- all awards of variable pay must be subject to malus and clawback provisions in line with regulatory requirements. Any awards made on, or after, 1 January 2015 will be subject to clawback for up to seven years following the date of the award, or such longer period as may be required. More detail on this can be found on page 72.

Remuneration for 2014

As explained in last year's report, the Bank applied malus in early 2014, cancelling all outstanding variable pay in respect of 2013 and preceding years. The Committee considers that no further action is required in respect of these cancelled awards.

2014 was a pivotal year for the Bank, bringing a focus on stabilisation, recapitalisation and simplification of the business. Overall, the Committee considers that the Bank performed well against a challenging and, at times, uncertain background, delivering significant improvements in a number of critical areas. The Bank exceeded expectations in relation to the key financial performance indicators of capital, liquidity and cost control – after allowing for investment and remediation. The Bank also performed satisfactorily overall against a range of strategic goals, although progress in some areas was slower than expected. Any turnaround is, by definition, likely to encounter difficulties and where these arose, the Bank adapted its plans to ensure longer term recovery goals were maintained. Whilst much has been achieved in 2014, and we have strengthened our foundations, we are conscious that our recovery is in its early stages and that much yet remains to be done.

Directors' Remuneration report continued

The regulators have accepted the Bank's plan, however any bonus awards for 2014 must be made with due consideration of the stability of the business overall. Having reviewed the overall achievements of the Bank during 2014, the Remuneration Committee's recommendations are as follows:

- Chief Executive Officer: The contractual arrangements for the CEO expressly preclude any annual bonus in respect of 2014 and therefore no such award is recommended. As part of the update of his contract, the Remuneration Committee has agreed that the Chief Executive Officer becomes eligible for an annual bonus for the whole of 2015. This proposal is set out in more detail, together with other proposals for 2015, below.
- Finance Director[1]: The Remuneration Committee has decided to make a payment under the Annual Incentive Plan of 68% of base salary. The Remuneration Committee considers this an appropriate reflection of performance against the business plan for the year and the award level proposed is consistent with the overall performance evaluation for the Bank as a whole. In line with regulatory requirements, 60% of this award will be deferred into cash and share equivalents, vesting over a three year period, and subject to both malus and clawback provisions. The balance will be payable in a mix of cash and share equivalents. More detail on the 2014 AIP performance outcomes is provided on page 71.

Award of a Long Term Incentive for 2014 to 2016

A key element of remuneration policy is the establishment of an appropriate Long Term Incentive Plan. The Bank had entered into contractual undertakings with a number of Executives in that regard, anticipating the introduction of a new LTIP in 2014.

On 4 December 2014 we announced our decision to cancel the General Meeting due to be held on 10 December 2014. The Board considered at that time that it was not appropriate for the Bank to ask shareholders to vote at the General Meeting on an LTIP scheme. The Bank announced that it would further consider the implications for performance before any such plan would be re-presented. The key changes agreed following this review extend the performance vesting period for any award made in respect of the 2014 undertaking and further increase a number of specific measures, including those relating to Total Risk Weighted Assets – in line with the plan accepted by the PRA.

Subject to shareholder approval for the LTIP overall, we therefore propose that both Executive Directors are granted a 2014 transitional LTIP award of 100% of salary. This 2014 award will be denominated in phantom shares, tracking the Bank's grey market share price, and will be subject to a performance period of three years, ending on 31 December 2017, followed by a holding period of two years. These awards will be subject to the same performance measures as the 2015 LTIP award, satisfying the contractual commitments agreed with the CEO at the time of his appointment to the Bank. For the sake of clarity, it should be noted that the two Executive Directors are being treated in the same manner for both the 2015 award and the 2014 transitional award. Both awards will be subject to malus and clawback in accordance with regulatory requirements.

Awards will be subject to both financial and strategic performance conditions, ie cost income ratio, absolute Total Shareholder Return (TSR), Total Risk Weighted Assets and strategic measures based on risk, people and customer. A CET1 ratio hurdle will also apply.

2015 policy and proposals

- Chief Executive Officer: The CEO's Role Based Allowance will reduce from £1,680,000 pa to £400,000 pa on 10 June 2015, as permitted by the terms of his contract. On the same date, the base salary will increase from £1,200,000 to £1,300,000 per annum. It is proposed that he becomes eligible for payment of an annual bonus in line with the AIP effective 1 January 2015 (up to a maximum of £1,250,000 in 2015). That bonus will be based upon the achievement of the Bank's annual business plan and subject to the prevailing regulatory requirements under the Deferred Bonus Plan.
- Finance Director: the Finance Director's remuneration arrangements remain unchanged and his annual bonus will be based on the achievement of the 2015 business plan. He is contractually entitled to continue to receive a Role Based Allowance.
- In accordance with the EBA's ruling on Role Based Allowances, these payments are regarded as fixed remuneration and may no longer be subject to specific performance conditions. Accordingly, the existing capital underpin relating to these allowances will be removed. Role Based Allowances will continue to be distinguished from base salary. They will not be pensionable but, in accordance with the EBA ruling, will be included in the calculation of any termination payments. Capital performance requirements have been incorporated into LTIP proposals as part of variable remuneration policy. It is the Bank's intention to progressively reduce Role Based Allowances in future years by rebalancing base and variable pay within permitted regulatory parameters.
- The maximum annual bonus opportunity for Executive Directors will be 100% of base salary and awards will vary in accordance with actual results. For 2015, AIP awards will be based on a combination of annual financial and strategic goals aligned to the Bank's strategic plan. For both Executive Directors, 60% of any annual bonus awarded in respect of 2015 will be deferred in line with regulatory requirements under the Deferred Bonus Plan.
- Subject to approval by shareholders of proposals to introduce a 2015 LTIP for a limited number of key Executives, it is proposed that both Executive Directors will be granted an award, under the terms of this proposed 2015 Plan, of 100% of base salary, denominated in phantom shares tracking the Bank's grey market share price (for the purposes of the 2015 LTIP grant, the base salary used for determining the number of shares will be as at 1 January 2015). These awards would be made following the 2015 AGM. All LTIP awards granted in 2015 will vest against a balanced scorecard of performance measures relating to the delivery of the plan over the period 2015-2017. Financial measures will form 60% of the scorecard, with the remainder linked to key strategic objectives, ie cost income ratio, absolute TSR, Risk Weighted Assets and strategic measures based on risk, people and customer. A Capital Resource Surplus hurdle will also apply.
- Following completion of the performance period, the LTIP will be subject to a further two year holding period (including the six month holding period, in line with regulatory requirements).

All awards of variable pay made in respect of 2015 will continue to be subject to malus and clawback provisions in line with regulatory requirements.

More detail on how the policy will be implemented in 2015 is provided on page 80.

1. Appointed as an Executive Director on 1 October 2014.

Consideration of stakeholders' views

We are committed to maintaining an open and constructive dialogue with all our stakeholders and take careful consideration of their views.

During the year, we consulted with our principal regulators, the FCA and the PRA. We also consulted extensively with a number of our largest shareholders on all significant aspects of remuneration, including our approach for addressing our regulatory obligations.

We are grateful for the engagement, support and the time commitment given generously to the Bank by all our stakeholders during these consultations.

We consider that the remuneration policies and practices set out here for shareholder approval represent a proportionate, transparent and fair reward for our Executive Directors, who are leading the Bank's recovery and turnaround. I hope you will consider these proposals against that background and support the resolutions relating to remuneration at the forthcoming AGM.

Maureen Laurie
Chair, Remuneration Committee
26 March 2015

Directors' remuneration policy

As the Company is not a publicly traded company, the Bank is not required to publish a Directors' Remuneration report in the form required by the Large and Medium Sized Companies and Groups (Accounts and Reports) Regulations 2008 (as amended) (the Regulations). However, the Committee has, in keeping with its intention to support good corporate governance, decided to prepare a Directors' Remuneration report in line with the Regulations and to put both the Annual Report on Remuneration and the Directors' Remuneration Policy to shareholders on an advisory basis at the 2015 AGM. It is intended that this policy will take effect immediately following approval at the 2015 AGM.

In preparing this report, we have considered listed company disclosure regulations.

Future policy

Element	Policy
Base salary	
Purpose and link to strategy	Externally competitive base pay allows us to attract and retain high-calibre Executives with the skill to develop, lead and deliver the business strategy.
Operation	Reflects the role of the individual within the Bank, taking account of responsibilities and experience.
	Base pay may be reviewed from time to time, but at no greater frequency than once annually. Any increase to base pay is subject to approval by the Remuneration Committee and would normally be applicable from 1 April.
	The Bank considers the levels of base pay by reference to independent advice on appropriate external market comparators. Objective job sizing against equivalent roles in comparable financial services companies is applied.
	The Committee is not obliged to adopt such data in determining levels of base pay, but will use it as a reference point to establish an appropriate level of pay overall, having regard to other relevant factors including corporate and individual performance, the individual's experience, regulatory developments and/or any significant changes in an individual's role and responsibilities.
Maximum opportunity	Base pay is not capped. Increases to base pay for Directors may be considered taking into account practice for employees generally across the Bank, regulatory requirements, consultation feedback and any relevant market information.
Performance measures	N/A
Role based allowance	
Purpose and link to strategy	To ensure that total fixed remuneration is commensurate with the prevailing requirements of the role and to provide a competitive reward package for key skills and capabilities.
Operation	Allowances are paid quarterly in cash and are non-pensionable.
	The role based allowance is subject to review in 2015, as a consequence of regulatory developments, and may change.
	Following an EBA ruling on RBAs (and their fixed status) which precludes any performance conditions, the Committee has determined that the capital condition will cease to apply from 1 January 2015 onwards. Due to the same regulatory development, the RBA will also be considered as part of the termination payment, as from 1 March 2015.
Maximum opportunity	Role based allowances will not exceed 100% of base salary in respect of any financial year.
Performance measures	N/A
Pension	
Purpose and link to strategy	The pension policy provides an important and competitive benefit within the overall remuneration package for Executive Directors.
Operation	Executive Directors are eligible to participate in the defined contribution pension arrangement or alternatively may choose to receive a cash allowance in lieu of pension. This cash allowance is set as a percentage of salary and is subject to taxation in accordance with other such benefits in the UK.
	Both of the current Executive Directors receive cash allowances, in lieu of pension contributions.
Maximum opportunity	The maximum pension contribution or cash allowance for Executive Directors is 16% of salary.
	Pension allowances for both Executive Directors are currently set at 16% of base salary per annum.
Performance measures	N/A

Directors' Remuneration report continued

Element	Policy
Benefits	
Purpose and link to strategy	Benefits are provided to attract and retain executives with the appropriate skills to drive the business and to ensure that the overall package is competitive in the market.
Operation	Executive Directors receive a benefits package generally set by reference to market practice in companies of a similar size and complexity and/or business scope.
	Benefits provided include a car allowance, private medical insurance, life insurance, health screening and income protection. Relocation support may be provided if required upon the appointment of a new Executive Director.
	The Committee may periodically amend the benefits available to all employees. The Executive Directors are eligible to receive such benefits on similar terms to other Senior Executives.
	In line with our approach to all employees, certain Bank products are offered to all employees at a discount. All benefits are fully disclosed and are subject to taxation as required.
Maximum opportunity	Benefits are set taking into account affordability and market practice for comparable roles. Costs may vary by provider from year to year. The Committee keeps the benefit policy and levels under review. It may remove benefits that Executive Directors receive or introduce other benefits if it considers it is appropriate to do so.
Performance measures	N/A
Annual Incentive Plan (AIP) and Deferred Bonus Plan (DBP)	
Purpose and link to strategy	To motivate Executive Directors to achieve and exceed the business plan, rewarding annual financial and strategic targets and adherence to Co-operative Bank Values, within the Bank's risk appetite.
	Deferral of part of the annual bonus is applied in accordance with the requirements of the Remuneration Code.
Operation	Annual bonus awards are discretionary and are determined by reference to the Bank's performance against a scorecard of financial and strategic goals.
	Awards may be made in cash and shares/share-like instruments. A minimum of 50% of the Award will be made in shares/share-like instruments.
	The level of deferral for the Executive Directors is as per the Remuneration Code. All share-based awards will also be subject to a minimum of six months retention period following the relevant vesting date in line with regulatory requirements.
	At the Committee's discretion, Executive Directors may receive an amount (in cash or shares) equal to the dividends which would have been paid on vested shares subject to a compulsory holding period, prior to release. No dividends will be payable on shares continuing to be held following the end of the compulsory holding period.
	Malus and clawback provisions apply to both the cash and share/share-like instrument awards, including the deferred elements. Malus and clawback provisions are explained in more detail in the notes to the policy table below.
	All deferral terms are kept under review to ensure that these continue to be applied in line with regulatory requirements and best practice guidance. The Committee retains the flexibility to alter these terms for successive awards to reflect changes in such requirements or guidance. The Committee will not alter terms for awards already conferred except for regulatory compliance.
Maximum opportunity	The maximum award opportunity under the AIP will normally be 100% of salary in respect of any financial year, including any deferred element.
	Annual bonus awards can be made up to 200% of total fixed remuneration[2] in respect of any financial year, less any other variable remuneration awarded in respect of that financial year.
Performance measures	An annual corporate scorecard based on targets for financial and strategic measures is developed for review and agreement at the start of each year by the Remuneration Committee. This forms the basis of the bonus pool. The allocation of that pool depends upon the level of achievement of the individual against their own scorecard or objectives.
	These measures include a combination of financial and strategic goals aligned to the Bank's strategic plan. Financial measures may include, but are not restricted to, such measures as underlying income, operating expenses, CET 1 ratio and Non-core RWAs. An underpin linked to a liquidity metric may also be introduced.
	Each year, the Committee will consider the appropriate mix of financial and strategic measures. These measures will be determined by the Committee, and will normally be allocated 50% to financial measures and 50% to qualitative/strategic objectives.
	Any bonus is discretionary and may range from zero to the maximum value. An individual's performance rating will determine the final bonus outcome (as well as affordability). In particular, before any bonus is awarded, the Committee will use its judgement to assess whether the amount of any bonus is appropriate by reference to business performance, and will include a mechanism to adjust for risk and conduct factors.
	Specific measures for determining the 2015 bonus pool are set out on page 80. Performance measures for future awards may be subject to change to ensure continued alignment with the business strategy.

2. Defined as base salary plus any cash based allowances (including car) plus role based allowance, plus pension contributions plus the cash value of any other associated benefits.

Directors' Remuneration report continued

Element	Policy
Long Term Incentive Plan	
Purpose and link to strategy	To incentivise senior management to deliver a sustainable Bank, by providing over the longer term value to shareholders, regulatory stability and, for customers, employees and other stakeholders, promoting the principles enshrined in the Bank's Values and Ethics Policy.
Operation	The Committee will determine the award levels to be granted in respect of any financial year, in compliance with regulatory requirements.
	Awards will be made in the form of share/share-like instruments.
	Vesting will be subject to the achievement of performance conditions over a period of no less than three years. Shares will then normally be subject to a further minimum 18 month deferral period, during which time shares cannot be sold. Awards will also be subject to a minimum six months' retention period following the deferral period, in line with regulatory requirements.
	At the Committee's discretion, Executive Directors may receive an amount (in cash or shares) equal to the dividends which would have been paid on vested shares prior to release. No such payments will be made for shares that are no longer subject to deferral or in respect of shares forfeited for malus/clawback.
	Malus and clawback provisions apply to awards in full and are explained in more detail in the notes to the policy table below.
	All terms of any long term incentive plan will be kept under review to ensure that these are in line with regulatory requirements, circumstance and best practice, and the Committee retains the flexibility to change the terms to take account of these pressures for future, and existing, awards.
Maximum opportunity	The maximum award opportunity under the LTIP will normally be 100% of base salary in respect of any financial year.
	Under the plan rules, LTIP awards may be made to a maximum of 200% of total fixed remuneration, less any other variable remuneration awarded in respect of that financial year, in exceptional circumstances.
	Details of the proposed 2015 LTIP awards are provided on page 81.
Performance measures	Performance measures for the LTIP are detailed on a Bank-wide scorecard and agreed by the Committee in line with the Bank's long term priority of delivering sustainable returns to shareholders.
	The Committee will consider granting awards based on an appropriate mix of financial and strategic measures. The split between these measures, for each grant, will be set annually by the Committee, and will normally be equally divided between financial and strategic objectives.
	25% of the maximum award will vest for threshold performance and 60% for on-target performance. Full vesting will occur at stretch performance levels. Targets are set by the Committee to be stretching within the context of the Bank's business plan.
	Before any part of any LTIP award may vest, the Committee must be satisfied that the Company's underlying financial performance justifies such vesting. This will be assessed by reference to a CET1 ratio.
	Specific measures for proposed 2015 LTIP awards are set out on page 81. Performance measures for future awards may be subject to change to ensure continued alignment with the business strategy and any future regulatory review or requirements.

Notes to the policy

Malus and clawback

Malus (being the reduction or forfeiture of unvested awards) and clawback (being the ability of the Bank to claim repayment of remuneration already paid) provisions apply to all variable remuneration provided by the Bank.

Any AIP awarded will reflect appropriate reductions made to incentive payments in relation to risk events. Individual bonus decisions may also reflect appropriate reductions in relation to specific risk and conduct events.

All variable remuneration may be reduced or cancelled in circumstances including the following:

- participant misbehaviour or material error;
- a material downturn in financial performance of the Bank or relevant business unit (malus only);
- a material failure of risk management of the relevant business unit or the Bank; and
- the Committee determines that the basis on which a participant was a 'good leaver' was incorrect.

Directors' Remuneration report continued

Amounts in respect of AIP, DBP and LTIP awards may be subject to clawback for up to seven years following award, if required, or such longer period as may be determined by regulatory requirements.

Legacy arrangements – 2013 Co-operative Group LTIP award for CEO (Group LTIP)

The Committee reserves the right to honour any previous commitments or arrangements entered into, provided they are in line with the Policy set out above, where the terms of the payment were agreed before the Policy came into effect or at a time when the relevant individual was not a Director of the Bank. Such payments are set out in the Annual Report on Remuneration for the relevant year.

In particular, Niall Booker, in his capacity as Chief Executive Officer was granted an award under The Co-operative Group LTIP upon his appointment, in respect of the performance period 2013-15. As a legacy arrangement, the Rules of the 2013 Group LTIP award are separate and are not covered by the Bank's policies. However, further details are provided below.

- *Purpose and link to strategy* – this one-off Group LTIP award was made to Niall Booker to address specific turnaround objectives deemed critical to the future success of The Co-operative Group and the Bank.
- *Operation* – following the Bank's separation from The Co-operative Group, it was agreed that one third, representing performance for 2013, would remain subject to the original performance measures, and liability for any awards relating to this tranche will be settled by The Co-operative Group.

  Liability for the remaining two thirds of the award was transferred to the Bank in 2013, with performance measures to be determined by the Bank for 2014 and 2015, specifically linked to financial and strategic performance (see below).

  The Rules of the Plan provide that payments will be satisfied in cash in 2016 and will be subject to the Remuneration Code.
- *Maximum opportunity* – the award value granted was 100% of base salary.
- *Performance measures* – the performance measures are based on specific turnaround objectives including capital, cost savings and other business critical issues.

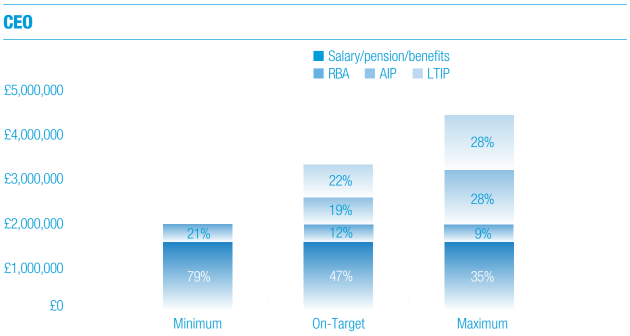
The performance period for the 2013 LTIP is due to end on 31 December 2015 and any payments resulting would be fully disclosed in next year's Directors' Remuneration report.

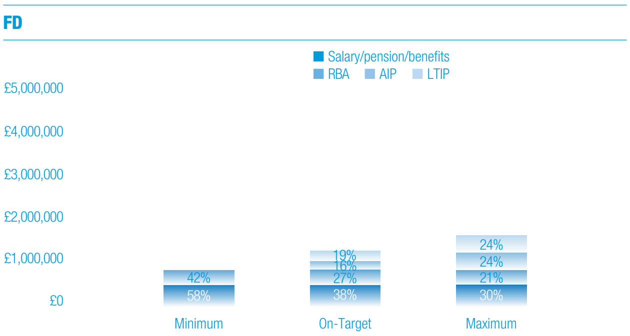
Illustration of application of remuneration policy

The charts below illustrate the potential total remuneration each Executive Director could earn in line with the forward looking policy table above. The charts show hypothetical values for the remuneration package for Executive Directors under three performance scenarios:

- minimum performance (fixed elements of remuneration only, corporate and/or personal performance not qualifying for AIP or LTIP awards);
- performance in line with expectation. Corporate and personal performance achieving target performance in line with annual business plan (or such other comparison which equates to the same level of difficulty) and long term measures; and
- maximum performance. Corporate and personal performance exceeding expectations to the maximum reward levels awarded under the AIP and LTIP.

The illustrations assume no share price growth and exclude dividends. The amounts are based on salaries as at 1 January 2015, applying the maximum opportunity of AIP and LTIP in accordance with our reward policy outlined in the policy table above.





For the CEO, we have used his forward looking remuneration policy from 10 June 2015, using the reduced Role Based Allowance and an updated annual bonus opportunity of 100% salary (a maximum of £1,250,000 for 2015). Until this time, his existing terms and conditions will apply.

Remuneration policy for Non-Executive Directors

Chairman	
Purpose and link to strategy	Provide a fee that is sufficiently market competitive to attract and retain a highly skilled Chairman to oversee and direct the execution of the business strategy.
Operation	The Chairman's fee is reviewed and approved by the Remuneration Committee on an annual basis. Increases to fees are not guaranteed and may not necessarily occur each year. Any amendments to the fee level will normally be effective from 1 April in any given year. The Chairman, receives no other benefits or remuneration in respect of his role apart from the basic fee, which is £300,000.
	Expenses incurred in the performance of the Chairman's Non-Executive duties for the Bank may be reimbursed or paid for directly by the Company, as appropriate, including any tax due on benefits.
Maximum opportunity	There is no maximum fee level. Fees are set in accordance with the individual's skills and experience and by reference to external market indicators for comparable roles in comparable institutions.
	Fee increases may be determined at any point in line with market movements and to take account of changes to the time commitment and duties involved.
Non-Executive Directors	
Purpose and link to strategy	Provide a fee that is sufficiently market competitive to attract and retain highly skilled Non-Executive Directors contributing expertise to the Board to oversee and drive the execution of the business strategy.
Operation	Non-Executive Director fees (excluding those of the Chairman) are reviewed by the Human Resources Director on an annual basis and considered and approved by the Chairman of the Board, the CEO and the FD, being members of the Board who have no personal interest in that fee structure. Non-Executive members of the Remuneration Committee do not participate in the process for evaluating and determining Non-Executive fees.
	Non-Executive Directors are paid a basic annual fee of £60,000, with an additional fee paid for the role of Senior Independent Director (£20,000) and for Board Committee Chairmanship (£20,000). Currently, no fees are paid for membership of a Board Committee. However, from 1 April 2015, a fixed annual fee of £15,000 will be paid for membership of a Committee. In addition, the fee for the role of Senior Independent Director will increase to £25,000 and the fee for Board Committee Chairmanship will increase to £25,000. It should be noted that these fees are payable only once, even if multiple Committees are attended or chaired. Any amendments to the fee level will normally be effective from 1 April in any given year.
	Non-Executive Directors do not take part in any performance pay, incentive plans or in any pension arrangement. However, expenses incurred in the performance of Non-Executive duties for the Bank may be reimbursed or paid for directly by the Company, as appropriate, including any tax due on benefits.
Maximum opportunity	There is no maximum level. Fees are set by reference to external market indicators for comparable roles in comparable institutions, and taking into account anticipated time commitments.
	Fee increases may be determined at any point in line with market movements and to take into account the time commitment and duties involved.

Approach to recruitment

Principles for recruitment remuneration	In determining remuneration arrangements for new executive appointments to the Board (including internal promotions), the Committee will take into consideration all relevant factors, including the calibre of the individual, the nature of the role, relevant comparable market practice, the individual's current remuneration package, current Bank remuneration policy and internal relativities, including existing arrangements for other Executive Directors.
	The Committee may make transitional arrangements to facilitate the recruitment of individuals of the required calibre from overseas, which might include relocation expenses and accommodation for a specific period of time. The Bank will not meet any personal tax or social security liabilities that may be due in the country of departure. All such benefits and payments will be made in accordance with UK taxation requirements, where applicable, and the Bank will not meet any tax liabilities arising in the country of departure.
	In exceptional circumstances, the initial notice period may extend beyond the maximum 12 month period applicable to Executive Director recruitment. Such notice obligations will be strictly time limited, and will apply on both sides. These will expire upon completion of the first year of appointment and notice will then revert to the standard 12 months required on either side, in line with the Company's policy.
	The Committee retains discretion to make appropriate remuneration decisions outside the standard policy to meet the individual circumstances when an interim Executive Director is required to fill a role on a short term basis or if exceptional circumstances require that the Chairman or a Non-Executive Director takes on an executive function on a short term basis. At all times however, the Committee will pay regard to the policy and supporting principles in order to determine the appropriate package required.
	Where a Senior Executive is promoted to the Board, his or her existing contractual commitments agreed prior to appointment may continue, at the discretion of the Committee, in accordance with the original terms. These arrangements may include any pre-existing deferred bonus or LTIP awards and will preserve all regulatory obligations.
Maximum variable pay limits	The maximum level of variable pay (as expressed as a multiple of base salary) which may be awarded to new Executive Directors in respect of their appointment shall not exceed the overall maximum variable pay limit of 200% of fixed remuneration, expressed in the remuneration policy table above, with an appropriate mix between annual bonus and LTIP opportunity.
	The value of any buy-out award which relates to forfeited awards from a previous employer is not included within the maximum limit above.
Buy-out awards	Where it is necessary to make a recruitment-related pay award to an external candidate, the Bank will limit such payments to the amount necessary to reflect the value of the forfeited remuneration.
	The Committee may buy-out bonus opportunities or incentive awards that the new Executive Director has forfeited as a result of accepting the appointment with the Bank, subject to proof of forfeiture where applicable. In all cases, the Committee will seek, in the first instance, to deliver any such awards under the terms of the Bank's existing incentive pay structure.
	All such awards for external appointments, whether under the AIP, DBP and LTIP or otherwise, to compensate for awards forfeited on leaving their previous employer will be determined after taking into account all relevant factors, including any performance conditions attached to the forfeited awards, the likelihood of these conditions being met, the proportion of the vesting/performance period remaining and the form of the award (for example cash or shares).
	All such awards will be made subject to the provisions of the Remuneration Code and any additional regulatory requirements that may be in place. In particular, awards will also be subject to malus and clawback provisions as required.
Recruitment of Non-Executive Directors	In the event of the appointment of a new Chairman or Non-Executive Director, remuneration arrangements will normally be in line with those detailed in the relevant table above. No payment will be agreed for the forfeiture of awards made for prior executive appointments given up on acceptance of the Bank's Non-Executive or Chair appointments.

Service contracts/loss of office

Key terms relating to the Bank's policy in the event of the voluntary or involuntary termination of the service of an Executive Director are set out in the table below.

The Bank's approach to any payments in the event of termination is to take account of the individual circumstances, including the reason for termination, any contractual obligations, outstanding incentives and pension scheme rules. Executive Directors' contracts do not include any specific compensation for severance as a result of a change of control.

Notice period	It is the Bank's policy that the notice period in Executive Directors' service contracts should not exceed one year. This may be varied on an exceptional basis upon recruitment but will not exceed 12 months after completion of the first year of service.
	The notice period of Messrs Booker and Baines are aligned with policy.
	The contracts of both Executive Directors provide that these undertakings will not apply in the event of material misconduct, neglect or other circumstances when summary dismissal by written notice may apply.
Termination payment	In the event of termination, payments due to an Executive Director would be based on the value of base salary, role based allowance and his contractual benefits.
	Executive Directors may be required to work some or all of the notice period or may be placed on garden leave. Alternatively, the individual may be provided a payment in lieu of notice (subject to mitigation where relevant).
	The Bank may contribute a sum towards the individual's legal fees incurred in relation to the termination of employment. All such payments will be subject to the approval of the Remuneration Committee or Chair of the Board as appropriate.
Incentive plans	Participation in all incentive plans is non-contractual and at the Committee's discretion, except in respect of legacy obligations to the CEO for the years 2013 and 2014 under terms agreed when he joined The Co-operative Group on 10 June 2013.
	AIP
	An Executive Director must normally be in the active employment of the Bank, and not be serving any notice period, on the date on which annual incentive plan awards are paid. The Committee would not normally authorise pro-rating of awards for part-year service, except in circumstances involving ill health or other exceptional events. Satisfaction of notice obligations while on garden leave will be excluded from the calculation of any awards due.
	In determining whether to award a bonus, the Committee will assess performance during the financial year. The Committee reserves the right to make any such payment fully in cash, subject to the satisfaction of regulatory requirements.
	Deferred bonus and LTIP
	In the event an Executive Director leaves for reasons of death, ill health, injury, disability, retirement (in accordance with the Company's retirement policy), the Company or division for which they work being transferred out of the Group or any other reason which the Committee in its absolute discretion determines, s/he may be treated as a good leaver.
	In good leaver scenarios, and in accordance with the terms of the Deferred Bonus Plan, awards may be released at the original vesting date, subject to malus/clawback provisions, and may be pro-rated to take into account the period of active employment relating to such awards at the Committee's discretion.
	Under the terms of the LTIP, awards for good leavers may vest and be released in accordance with the terms of that award and will not ordinarily be brought forward, except in cases of death or serious ill health.
	In such cases the Committee may authorise release of the awards, subject to consideration of any adjustments due to reflect pro-rata performance and time and subject to malus/clawback provisions. Such decisions will be made at the Committee's absolute discretion, with due regard to the circumstances.
	For all other leavers, unvested DBP and LTIP awards will lapse.
Change in control	In the event of a change in control, all outstanding awards granted under the DBP and LTIP will vest on the date of that event, to the extent that the Remuneration Committee determines that the performance conditions have been met at that time, and after applying time pro-rating to the award, providing that the Remuneration Committee may use its discretion to waive the performance conditions and time pro-rating.

The Committee reserves the right to make any remuneration payments and payments for loss of office (including, where relevant, exercising any discretions available to it in connection with such payments) in satisfaction of existing contractual agreements.

The Chairman and the Non-Executive Directors do not have service contracts or contracts for services. Their appointment letters provide for no entitlement to compensation or other benefits on ceasing to be a Director.

Differences in remuneration policy from wider employee population

The Bank has one remuneration policy that is openly communicated and applied broadly consistently throughout the organisation. Our policy has been designed to support recruitment, motivation and retention as well as to reward high performance provided it is achieved within the Bank's risk appetite, and is aligned with the principles of the Bank's Values and Ethics Policy.

The principles set out in the policy table inform remuneration decisions for all employees, not only Executive Directors, and the Committee takes into account pay levels and benefit arrangements throughout the Bank to ensure the arrangements provided to Executive Directors remain appropriate.

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

- AIP – all employees are eligible to participate in the AIP. Corporate performance measures are consistent for AIP Executive Directors and other employees, although the level of bonus will differ by role to reflect levels of accountability and contribution to results. Bonus awards payable to employees classified as material risk takers for regulatory purposes will be subject to deferral and part-payment in shares/share-like instruments in accordance with regulatory requirements.
- LTIP – a limited number of Senior Executives may be invited to participate in the Bank's LTIP, and this is determined by role, having regard to accountability for delivery of the business plan and strategy. The terms of such LTIP 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.

Consideration of shareholder views

The Committee is committed to ongoing dialogue with shareholders and seeks the views of significant shareholders when any major changes are being contemplated.

The Committee takes into account the views of significant shareholders when formulating and implementing the policy. In particular, the Committee consulted with its major shareholders in the development of the Deferred Bonus Plan and LTIP during the course of 2014 and early 2015.

Report on remuneration

The Annual Report on Remuneration sets out how the Bank's policy was implemented in 2014, and how it will be implemented in 2015.

Single total figure of remuneration – Executive Directors

The following table shows a single total figure of remuneration for 2014 in respect of qualifying service for each Executive Director together with comparative figures for 2013.

Single figure £000s

Audited

Executive Director	Salary	Benefits	Pension	Role based allowance	Annual variable pay (AIP)	Payments for loss of office	Total remuneration
2014							
Niall Booker	1,200	16	192	1,680	–	–	3,088
John Baines	100	4	16	88	182	–	390
Rodney Bulmer	97	4	15	–	–	–	116
2013							
Niall Booker	669	10	111	943	–	–	1,733
John Baines	–	–	–	–	–	–	–
Rodney Bulmer	272	11	43	–	–	–	326

Rodney Bulmer was appointed as an Executive Director on 18 May 2013 and resigned on 28 February 2014.

John Baines was appointed as an Executive Director on 1 October 2014 and the salary in the table above is in respect of his period of service as an Executive Director. He was engaged as an employee from 1 May 2014 and his AIP is reported in respect of his period of time as an employee in 2014.

Niall Booker was appointed as an Executive Director on 10 June 2013. As a result, his 2013 numbers are pro-rated from that point.

Variable pay in respect of 2014

AIP awards

This reflects the total AIP awards to be paid in April 2015 based on performance in the year ended 31 December 2014. This includes both the cash element and the portion deferred into shares.

As outlined in the Remuneration Committee Chairman's letter, irrespective of the Bank's performance in 2014, the CEO was not eligible to receive an annual bonus award for that performance year. This section therefore deals only with the Finance Director.

In line with policy, the Finance Director's AIP award in respect of performance during 2014 was measured against a basket of financial and strategic metrics and upon his personal objectives. Performance outturns in respect of each element of the AIP are set out in the table below.

For each of the performance conditions, Committee judgement has been used in assessing performance against targets using a scoring system out of 10. 5/10 represents target performance, with 0/10 representing threshold performance.

Audited

Measure	Weighting	Score	Assessment	Outcome (% max)
Cost/Income Ratio	15%	4.7/10	47%	7%
Core Tier 1 Ratio	15%	10/10	100%	15%
Liquidity	10%	7/10	70%	7%
Financial	**40%**			**29%**
IT Remediation	15%	5/10	50%	7.5%
Management of Core/Non-core assets	15%	10/10	100%	15%
Rebalancing of Core/Non-core Bank	15%	8/10	80%	12%
Brand: people/culture/customer/NPS	15%	3.3/10	33%	5%
Strategic	**60%**			**39.5%**
Total	**100%**			**68.5%**

Directors' Remuneration report continued

The Committee reviewed a comprehensive report from the CRO to ascertain that the Executive Directors' objectives had been fulfilled within the risk appetite of the Bank. In addition, the Committee considered further analysis from the relevant risk and compliance functions that there were no material issues to consider around regulatory breaches or customer outcomes that might prevent payment of any AIP award or trigger any malus. The Committee was satisfied that the AIP award should be made to the Finance Director.

The Committee also reviewed 2014 bonus outturns in the context of the relevant gateway criteria of affordability, reputational damage, and relative performance of the Bank to that of its peers. The Committee was satisfied that the Bank's performance in respect of these gateways justifies the payment of the AIP award to the Finance Director.

Deferral policy

In line with the Remuneration Code, 60% of all 2014 AIP awards to Executive Directors are deferred for up to three years.

Audited

Executive director	Cash bonus £000s	Deferred bonus £000s	Total bonus £000s
2014			
Niall Booker	–	–	–
John Baines	73	109	182
Rodney Bulmer (resigned 28 February 2014)	–	–	–

Cash bonus includes up-front cash and phantom shares deferred for six months.

2014 transitional LTIP award

Subject to receiving shareholder approval for the LTIP at the 2015 AGM, Executive Directors will be granted transitional LTIP awards of 100% of salary in recognition of performance in 2014, and in order to honour contractual commitments made to grant LTIP awards in respect of 2014.

The performance measures, targets and timeframes for the transitional LTIP awards will be the same as outlined on page 81 in respect of the normal 2015 LTIP awards.

Non-Executive Director remuneration – 2014

The table below shows the current fee structure and actual fees paid in 2014 to Non-Executive Directors.

Audited

£000s	Base fee 2014	Committee Chairman fee 2014	Total fee 2014	Total fee 2013
Dennis Holt (Chairman from 27 October 2014)	126	–	126	–
Laura Carstensen (from 27 May 2014)	35	12	47	–
Richard Coates (Interim SID from 1 October 2014)	60	20	80	67
Graham Hardie	60	20	80	46
Maureen Laurie (from 30 June 2014)	30	10	40	–
William Thomas	60	–	60	10
Derek Weir (from 25 July 2014)	26	–	26	–
Richard Pym (resigned 1 October 2014)	137	–	137	100
Anne Gunther (resigned 30 May 2014)	25	9	34	71
Merlyn Lowther (resigned 30 May 2014)	25	–	25	67
Alistair Asher (resigned 24 March 2014)	–	–	–	–

The terms of Richard Pym's appointment as Chairman included an agreement that the Bank make an annual corporate donation of £20,000 per annum to the University of Warwick undergraduate scholarship fund and £100,000 per annum to High Barnet Baptist Church (registered charity 208653). Both donations paid quarterly in arrears. The total donations paid during 2014 and up to the date of Richard Pym standing down as Chairman of the Bank was £90,000. These payments are in addition to the number stated above.

Alistair Asher is an employee of the Co-operative Group Limited, and his fees of £60,000 per annum were due during his period of office to The Co-operative Group. Alistair Asher resigned from the Board on 24 March 2014.

Directors' Remuneration report continued

Payments for loss of office

Former Executive Director Rodney Bulmer resigned and left office without receiving a payment for loss of office. There were no payments to Executive Directors for loss of office in 2014.

Implementation of the policy in 2015 – Executive Directors

It is proposed to operate our forward looking remuneration policy in the following way in 2015:

Salary

With the exception of the CEO's salary (see below), Executive Directors' salaries will remain unchanged under the annual compensation review process, as at 1 April 2015.

Name	Annual base salary as at 31 March 2015	Annual base salary effective 1 April 2015	% increase
Niall Booker	£1,200,000	£1,200,000	0%
John Baines	£400,000	£400,000	0%

In line with the review of his contractual arrangements, Niall Booker's salary will be increased from £1,200,000 to £1,300,000 on 10 June 2015, at the same time as his role based allowance will be decreased to £400,000 from £1,680,000.

Role based allowances, pension and benefits for 2015

Pension and benefits for 2015 to be in line with policy, as outlined in the policy table on page 70.

Role Based Allowances (RBA) will continue to be used in 2015. Following an EBA ruling on RBAs (and their fixed status) which precludes any performance condition, the Committee has determined that the capital condition will cease to apply from 1 January 2015 onwards. From the same policy clarification, the RBA will also be considered as part of the termination payment, from 1 March 2015.

Niall Booker's RBA will reduce to £400,000 from 10 June 2015.

Variable pay

Our proposed variable pay framework for 2015 is outlined below. As outlined above, shareholders approved in 2014 the flexibility to pay variable remuneration up to twice the amount of fixed remuneration, and our framework for 2015 falls within this limit.

AIP awards in respect of 2015 financial year

The bonus structure will be consistent with the policy detailed in the remuneration policy section of this report in terms of the maximum bonus opportunity, deferral and malus provisions. The maximum opportunity takes into account the variable pay cap of twice the fixed remuneration approved by the Bank's shareholders. The measures have been selected to reflect a range of financial and strategic goals that support the key strategic objectives of the Bank. The performance measures and weightings are shown below.

Maximum opportunity for 2015	CEO: 100% of base salary FD: 100% of base salary
Performance measures and targets	The Committee gave careful consideration to the selection of performance measures for the 2015 AIP awards, and has chosen measures which it believes directly support the Bank's strategy. The 2015 AIP awards will be subject to the following performance measures: **Financial measures (50%):** • Underlying income, operating expenses, CET1 Ratio and Non-core Risk Weighted Assets **Strategic/other non-financial measures (50%):** • IT remediation, process improvements and a range of brand metrics: people/culture/customer **Individual performance:** In addition, before any part of the 2015 AIP award can be considered, the Committee must be satisfied that the Company's underlying financial performance justifies payment. This will be assessed by reference to one key underpin: liquidity risk appetite. Detail of the targets for the annual bonus in respect of 2015 is commercially sensitive and it is not appropriate to disclose this information externally. Disclosure of the Bank's achievement against the targets will be made in the 2015 Annual Report and Accounts, subject to the sensitivity no longer remaining.

Directors' Remuneration report continued

LTIP – 2015 awards

Subject to receiving shareholder approval for the LTIP at the 2015 AGM, an award of 100% of salary in respect of 2015 will also be made.

All LTIP awards granted in 2015 will be subject to malus and clawback provisions in line with the remuneration policy.

Maximum opportunity – 2015 grants	For both the CEO and FD: 100% of base salary.
Performance measures and targets	For all LTIP awards granted in 2015, the performance period will be three financial years from 1 January 2015. The Committee consulted widely with its major shareholders during the course of 2014 and early 2015 in relation to appropriate performance measures and how to most effectively incentivise Executive Directors to deliver the long term objectives of the turnaround and sustainable returns to shareholders, to maximise alignment with shareholders. Based on the feedback, the Committee has proposed that awards made in 2015 will vest by reference to a balanced scorecard of performance measures, as follows: **Financial measures (60%):** • Cost/Income Ratio (20%) • Absolute TSR per share (20%) • Total Risk Weighted Assets (20%) **Strategic measures (40%):** • Risk and Control (10%) • A range of People metrics (15%) • A range of Customer metrics (15%) In addition, before any part of the 2015 LTIP award can vest, the Committee must be satisfied that the Company's underlying financial performance justifies vesting. This will be assessed by reference to one key underpin, CET1 ratio, being sufficient.

Implementation of the policy in 2015 – Non-Executive Directors

Following a review of Non-Executive Director remuneration, from 1 April 2015, the role of Senior Independent Director will increase to £25,000, the fee for a Committee Chairmanship will increase to £25,000 and we will introduce a Committee Membership fee of £15,000. It should be noted that these respective fees are payable once only, even if multiple committees are attended or chaired.

Remuneration Committee

The Remuneration Committee has the delegated responsibility to determine remuneration for the Executive Directors and the Executive Committee of the Bank, and to set and recommend to the Board for approval, the overarching principles and parameters of the Remuneration Policy across the Bank to ensure an overall coherent approach to remuneration for all employees. In addition, the Remuneration Committee ensures remuneration is compliant with the Prudential Regulation Authority's Remuneration Code and the UK Corporate Governance Code.

The Remuneration Committee met 15 times in 2014. The frequency of meetings was higher than usual, due to the exceptional nature of 2014 activities for the Bank, including the ongoing development of the remuneration policy and share plans, regulatory developments impacting the Bank, and changes in the Remuneration Committee composition. During 2014, the members of the Committee were as follows:

	Date of appointment	Date of resignation	Attended (entitled to attend)
Maureen Laurie (Chair)	30 June 2014		6(6)
Graeme Hardie			15(15)
Dennis Holt[1]	25 February 2014		12(13)
Laura Carstensen	30 May 2014		5(6)
Anne Gunther[2]		30 May 2014	9(9)
Richard Coates		30 May 2014	9(9)

1. Dennis Holt acted as Interim Chairman of the Remuneration Committee during the period 30 May 2014 to 30 June 2014.
2. Anne Gunther was Chair of the Remuneration Committee during 2014 until she stood down as a Director of the Company at the conclusion of the AGM on 30 May 2014.

Directors' Remuneration report continued

The Committee regularly consults 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, Policy and Employee Relations 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, and Values and Ethics Committee.

Advisors to the Committee

The Committee received support and advice from external advisors during the year. From time to time, the Committee will undertake due diligence to ensure that the advice it receives is independent. The table below provides details of the external advisors to the Committee and the respective fees paid to them in 2014. 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 fees paid in 2014 to remuneration advisors for remuneration-related advice to the Committee was:

Name	2014 fees £m
Deloitte LLP[1]	0.5
Mischon de Reya	0.2

1. For the period May 2014 onwards.

Statement of voting at last AGM

The results of the vote on the Directors' Remuneration Report at the 2014 AGM is shown in the table below.

Resolution	Votes for	% of Votes cast	Votes against	% of Votes cast	Total Votes validly cast	Votes as a % of issued ordinary share capital[1]	Votes Withheld
2 To receive and approve the Directors' Remuneration report for the year ended 31 December 2013	202,502,426	99.55%	919,591	0.45%	203,422,017	81.37%	–
14 To authorise the Bank to apply a ratio of the fixed to variable components of total remuneration for 'Remuneration Code Staff' that exceeds 1:1, provided that the ratio does not exceed 1:2	202,502,426	99.55%	919,591	0.45%	203,422,017	81.37%	–

- 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 of members.
- Resolution 14 was a special resolution.

Pillar III Disclosures on Material Risk Taker remuneration

The Remuneration Committee has the responsibility to oversee remuneration for staff identified as Material Risk Takers.

In 2014, as part of 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 has been revised. As part of these changes, the European Banking Association (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 2014, 58 Material Risk Takers have been identified within the Bank according to the new criteria. This list has been 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 (eg cash linked to the Bank's share price); and
- risk-adjustment of any variable remuneration award, including malus/clawback on AIP, DBP and LTIP awards. In particular, for any award made on or after 1 January 2015, clawback may apply for up to seven years following award. Risk-adjustment of remuneration, including malus and clawback, is decided by the Remuneration Committee on the basis of information provided by The Co-operative Bank internal control functions and an independent report provided by the Chief Risk Officer.

This section discloses the remuneration awards made by the Bank to Material Risk Takers in respect of the 2014 performance year.

1. Aggregate remuneration – by division

	2014	
Division	Number of Material Risk Takers	Total Remuneration £m
Retail banking[1]	13	7.2
Corporate functions	45	10.6
Total	58	17.8

1. CEO included in Retail Banking division.

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

	2014	
Division	Number of Material Risk Takers	Total Remuneration £m
Senior Management[2]	8	8.3
Other	50	9.5
Total	58	17.8

2. Senior Management consists of ExCo members only.

3. Aggregate remuneration – by fixed/variable remuneration

	2014	
Division	Senior Management £m	Others £m
Total fixed remuneration[3]	**6.8**	**7.8**
Total variable remuneration:	**1.5**	**1.7**
Cash bonus (AIP)[4]	0.5	0.5
Deferred bonus (DBP)[5]	0.7	0.3
Transitional Deferred Award (TDA)[6]	0.3	–
Retention plan 2014[7]	–	0.9
Total	**8.3**	**9.5**

3. Includes pension contribution.
4. Consists of up-front cash and phantom shares deferred for six months.
5. Consists of cash and phantom shares deferred from one to three years with pro-rated vesting.
6. Transitional Deferred Award consists of phantom shares deferred for four years with cliff vesting, subject to a performance underpin.
7. The retention plan for 2014 was implemented to address key management risks in certain functional areas.

A transitional LTIP award in respect of 2014 will be granted to certain members of senior management in 2015, subject to shareholder approval at the AGM.

Directors' Remuneration report continued

4. Aggregate remuneration – deferred remuneration

Division	2014 Senior Management £m	2014 Others £m
Unvested deferred remuneration from previous years[1]	2.3	3.5
Deferred remuneration reduced in 2014 through performance adjustments[2]	(1.5)	(3.5)
Deferred remuneration awarded in 2014[3]	1.0	1.2
Deferred remuneration from previous years paid out in 2014	–	–
Deferred unvested remuneration outstanding at 31 December 2014	1.8	1.2

1. As reported in last year's Directors' Remuneration Report, £5.0m was the total deferred for both Senior Management and Others. In addition, the legacy Group LTIP of £0.8m awarded to the CEO was reported separately. Further details of the legacy Group LTIP award are provided on page 73.
The 2013 legacy Group LTIP awarded to the CEO had a face value of £1.2m. The figure of £0.8m represents the maximum payout remaining under the rules of the plan for The Co-operative Bank. The balance of the award is the responsibility of The Co-operative Group. The number above represents the maximum LTIP award for the performance period ending 31 December 2015. Any vested amount would be paid out in early 2016.
2. As reported in last year's Directors' Remuneration Report, in light of recent events, the Committee decided to apply malus to all outstanding deferred remuneration with the exception of the legacy Group LTIP award to the CEO granted by The Co-operative Group.
3. Deferred remuneration awarded for performance year 2014 under the Deferred Bonus Plan, the Transitional Deferred Award plan and the Bank Retention plan.

5. Aggregate remuneration – sign-on and severance payments

Division	2014 Number of beneficiaries	2014 Senior Management £m	2014 Others £m
Sign-on payment[4]	–	–	–
Severance payment[4,5]	–	–	–

4. There were no sign-on payments in 2014. There were three buy-out agreements for new hires in 2014 totalling £114k. The highest payment was £82k. These payments are to compensate the employee for forfeited bonus opportunity because they have joined the Bank.
5. There were no severance payments to Executives in 2014.

6. Aggregate remuneration – high earners by band

Number of staff with total remuneration of EUR 1 million or more in 2014, by band[6,7]	2014
€1m–€1.5m	3
€1.5m–€2m	–
€2m–€2.5m	–
€2.5m–€3m	–
€3m–€3.5m	–
€3.5m–€4m	1

6. In accordance with Article 450 of the Regulation under CRD IV, the reporting of aggregate remuneration – high earners by band is prepared in Euro.
7. Includes permanent employees only and excludes contractors.

Maureen Laurie

On behalf of the Board

Maureen Laurie
Chair, Remuneration Committee

Risk management

Risk Management

Introduction

This section of the Annual Report and Accounts explains the management of risks faced by the Bank.

The risk management notes provide disclosures enabling the evaluation of:

- the significance of financial instruments for the Bank's financial position and performance;
- the nature and extent of risks arising from financial instruments to which the Bank has been exposed during the year and at 31 December 2014; and
- how the Bank manages those risks.

Disclosures provided are based on the information used by management in managing the Bank.

The principal risks are summarised in the Strategic report section of this Annual Report and Accounts.

Disclosures under IFRS 7 'Financial Instruments: Disclosures' (IFRS 7) concerning the nature and extent of risks relating to financial instruments have been included in the audited sections of Risk Management on pages 95 to 130 and the EDTF table on page 291.

The Bank's Pillar III document which can be found at http://www.co-operativebank.co.uk/investorrelations/financialresults. This contains further disclosures including many of the recommendations made by the Enhanced Disclosure Task Force (EDTF), which are summarised in the EDTF table in Appendix I of the Annual Report and Accounts.

Changes to disclosures

The Financial Stability Board, which co-ordinates at international level the work of national financial authorities and international standard setting bodies, established the EDTF to make recommendations for enhancing banks' risk disclosures to better meet users' needs. The Bank has, to the fullest extent possible, implemented these recommendations in full for 2014 either within the Annual Report and Accounts or Pillar III disclosures.

Details of the Bank's compliance with the EDTF recommendations are shown in Appendix I. Further information regarding the EDTF recommendations can be found at: http://www.financialstabilityboard.org/2014/09/r_140930a/.

Risk Governance structure

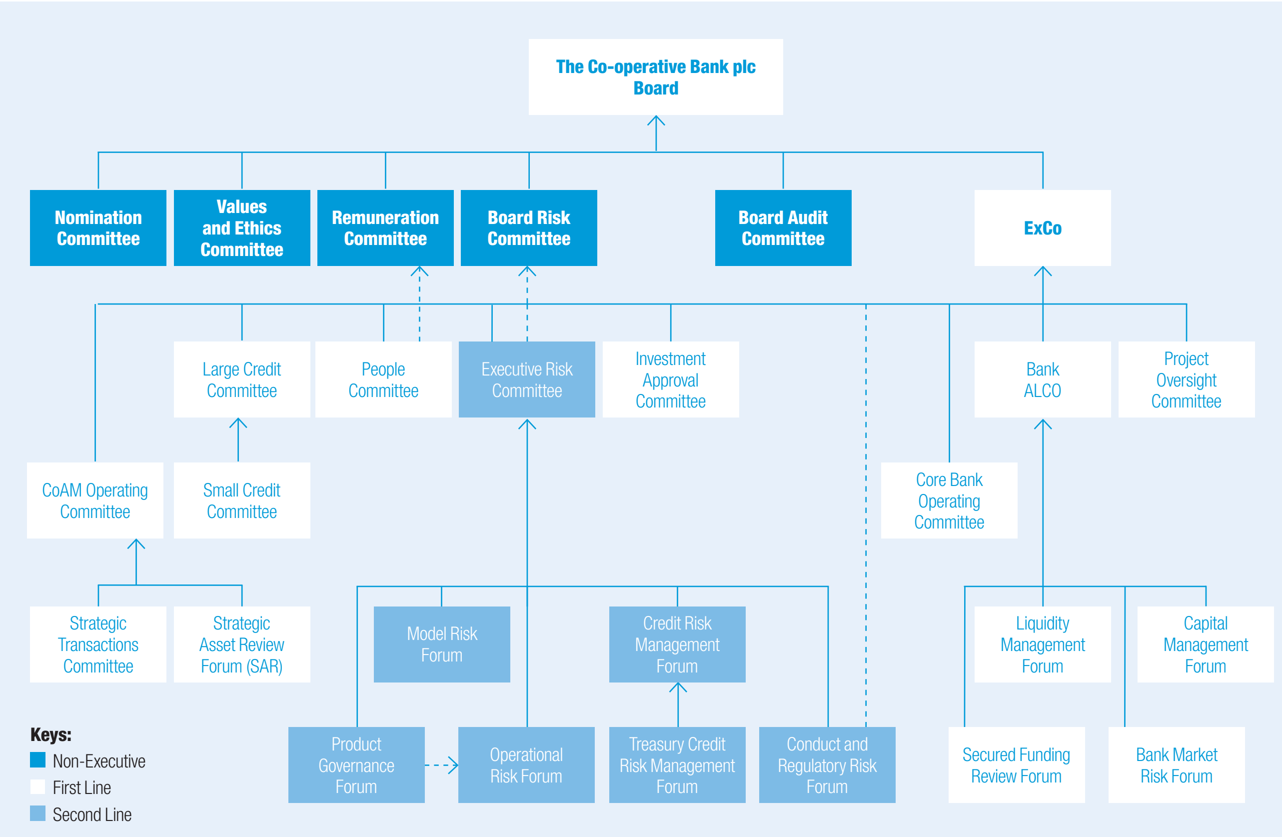
Risk management – 2014 overview

The management of risk lies at the heart of the Bank. One of the main risks incurred arises from the extension of credit to customers through regulatory operations of the Bank. Beyond credit risk, the Bank is also exposed to a range of other risk types such as market, liquidity, operational, pension, conduct, reputational and other risks that are inherent to its industry, strategy, product range and geographical coverage.

The Bank continues to operate the 'three lines of defence' governance model, to ensure appropriate responsibility and accountability is allocated to management, whilst recognising that the system is designed to manage rather than eliminate risk of failure to achieve business objectives. The three lines of defence are:

- the Bank's business teams and first line management act as the first line of defence and are responsible for identifying where a business unit is exposed to risks, including from the development of new products, processes or other business change. They also manage the risks that reside within their business units on a day-to-day basis, implementing effective monitoring and control processes to ensure that the Bank's business' risk profile is understood and maintained within the Board defined risk appetite;
- the Bank's compliance and risk functions act as the second line of defence. They oversee and challenge the implementation and monitoring of the risk framework and consider current and emerging risks across the Bank. They also review and challenge the delegated authority framework and oversee appropriate escalation of breaches, mitigating actions and reporting to the Executive Risk Committee (ERC); and
- the Bank's internal audit function acts as the third line of defence. It is responsible for independently verifying that the principal risk control framework has been implemented as intended across the business and challenging the overall management of the framework to provide assurance to the Audit Committee and senior management as to the adequacy of both the first and second lines.

The diagram below illustrates the Bank's Risk Management Committee structure as at the end of 2014. The Bank continues to review and refine this structure.



First line Committees are responsible for ensuring that the risk and control environment is established and maintained in day-to-day decision making. The second line Committees give oversight and challenge to the first line and review and approve the component parts of the Risk Management Framework that are designed in the first line.

Board and sub-committees

The Bank's risk governance structure provides risk evaluation and management whilst ensuring the Bank manages the regulatory environment as efficiently as possible. The risk focus of these Committees is described below:

Committee	Risk focus
The Board	The Board has collective responsibility for the long term success of the Bank. Its role is to provide leadership of the Bank within a framework of prudent and effective controls which enables risk to be assessed and managed. It sets the Bank's values and standards and ensures that its obligations to its shareholders, customers and other stakeholders are understood and met. The Board 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 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.
Remuneration Committee	The Remuneration Committee determines the remuneration for the Executive Directors and the Executive Committee of the Bank and it sets and recommends to the Board for approval, the overarching principles and parameters of the remuneration policy across the Bank to ensure an overall coherent approach to remuneration for all employees.
Board Risk Committee (BRC)	The BRC is responsible for the review and report of its conclusions to the Board in respect of the Bank's risk appetite and Risk Management Framework, taking a forward looking perspective and anticipating changes in business conditions.
Audit Committee (AC)	The AC monitors, reviews and reports to the Board on the formal arrangements established by the Board in respect of the financial and narrative reporting of the Bank, the internal controls and the Risk Management Framework, and the internal/external audit process.
Nomination Committee (NC)	The NC reviews and makes recommendations on Board 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.
Values and Ethics Committee (V&E)	The V&E Committee recommends to the Board for its approval and adoption of the Co-operative Values and Ethical Policies of the Bank and to advise the Board of the Bank's conformity with such values and ethics in its operations and activities.

The Initial Public Offering (IPO) Committee is a special purpose Committee not considered part of the overall governance structure described above.

Executive and management Committees

The Executive has established sub-committees and senior management Committees whose responsibilities include implementing the Risk Management Framework, identifying the key risks facing the business and assessing the effectiveness of planned management actions. These are detailed below:

Committee	Risk focus
Executive Committee (ExCo)	ExCo manages the business in line with the risk appetite statement, and in doing so ensures the implementation of the risk strategy set by the Bank's Board so as to deliver an effective risk management environment.
Executive Risk Committee (ERC)	The ERC is chaired by the CRO. Its purpose is to provide a mechanism to ensure all the Bank's risks are reviewed, challenged and approved in line with decisions made at ExCo (with escalation to the BRC where required).
Large Credit Committee (LCC)	The LCC supports the CEO in sanctioning large counterparty transactions and managing large exposure positions.
Small Credit Committee (SCC)	The SCC is a sub-committee of the LCC and its core purpose is to independently sanction new and increased lending over set limits of authority.
Strategic Transactions Committee (STC)	Chaired by the CEO, the STC reviews, challenges and approves (where permitted within the authority delegated by the Board) strategic transactions designed to achieve the deleveraging of the balance sheet in line with the strategy outlined by the Board for the Non-core assets within the Co-operative Asset Management (CoAM) business. Any deal sanctioned by the STC must be approved by the CEO and Finance Director of the Bank or the Treasurer of the Bank (up to the limit of their delegated authority) and a risk assessment must be carried out by the CRO or other director in the Risk division.
Bank Asset and Liability Committee (ALCO)	ALCO is chaired by the Finance Director. It is primarily responsible for overseeing the management of capital, market, liquidity and funding risks. Its responsibilities include: • identifying, managing and controlling the Bank's balance sheet risks in executing its chosen business strategy; • ensuring that the capital and liquidity position of the Bank is managed in line with policy and that adequate capital is maintained at all times; • overseeing and monitoring relevant risk control frameworks; • recommending relevant principal risk policies and detailed risk appetite limits to the CEO and the ERC for approval; and • approval of all product pricing proposals. To assist in carrying out these responsibilities, ALCO is supported by a Bank Market Risk Forum (BMRF), Liquidity Management Forum (LMF), Secured Funding Review Forum (SFRF), and Capital Management Forum (CMF).
People Committee	The Executive People Committee is chaired by the Human Resources Director and is responsible for the review of key people data within the Bank such as headcount and retention and to oversee the hiring of senior roles and all remuneration policies below the Executive level.
Core Bank Operating Committee	Responsible for the delivery of the business plan covering all areas of the Retail and Commercial Bank scorecard and provides oversight of performance. The Core Bank Operating Committee drives first line management of risk across the Retail and Commercial Bank and ensures that a robust and effective control environment exists.
CoAM Operating Committee	Chaired by the Managing Director CoAM, the CoAM Operating Committee is responsible for managing and reviewing the performance of CoAM against both operational and financial objectives in line with the business plan. It reports to the Executive Committee regarding progress of deleverage of the Non-core balance sheet. The CoAM Operating Committee drives first line management of risk across CoAM, ensures that the correct governance processes are followed and that a robust and effective control environment exists.
Strategic Asset Review Forum (SAR)	A forum established at the discretion of the LCC and SCC for all CoAM and BaCB non-performing facilities. Its function is to set strategies on a case-by-case basis and sanction within its authority.
Product Governance Forum	The Product Governance Forum provides independent review and challenge of product proposals, to ensure effective identification, assessment and mitigation of risks prior to launch.
Operational Risk Forum (ORF)	Oversees the design and maintenance of the Bank's operational risk framework and the risk control frameworks. In addition to this the ORF recommends to the CEO, CRO and the ERC relevant underlying policies and detailed risk appetite limits for approval.
Conduct and Regulatory Risk Forum (CRRF)	The core purpose of the CRRF is to support the Regulatory Risk Director in providing oversight of the Bank's Risk Management Framework in respect of regulatory and conduct risk and maintenance of the appropriate authorisations for the regulated entities within the Bank, including oversight of any variation to permission policies.

Executive and management Committees continued

Committee	Risk focus
Model Risk Forum (MRF)	The MRF responsibilities include: • setting and approving the model review process and standards; • reviewing and recommending to the CEO and ERC the Bank's model risk policy for approval; • review and approval of the Model Risk Control Standard; and • defining the review schedule for existing models and other tasks as identified in the Model Risk Policy.
Liquidity Management Forum (LMF)	LMF is a forum reporting to the ALCO. The role of the LMF is to define the lower level governance requirements for Liquidity Risk across the whole Bank. Liquidity risk materialises if the Bank does not hold sufficient liquidity to meet expected and unexpected liabilities when they become due or requested, without sustaining unacceptable losses. The forum will oversee and challenge all aspects of liquidity risk management within the Bank and make recommendations to ALCO as appropriate.
Credit Risk Management Forum (CRMF)	The CRMF advises and supports the CRO in designing the credit risk control implementation approach and the Credit Control Framework. It also recommends to the ERC the Credit Risk Policy, credit measurement methodologies and risk appetite. The Treasury Credit Risk Management Forum feeds into this forum specifically in relation to Treasury matters.
Bank Market Risk Forum (BMRF)	The role of the BMRF is to review, challenge and monitor the market risk profile for the Bank, in line with applicable policies and within risk appetite. BMRF is a forum reporting to the ALCO. The role of the BMRF is to define the lower level governance requirements for market risk across the whole Bank.
Secured Funding Review Forum (SFRF)	SFRF's role is to review and progress any issues which may impact either current or future planned secured funding, along with the review of all monthly, quarterly, semi-annual and annual returns for the secured funding vehicles. The primary monitoring of secured funding is via the Committee, with all new issuance and delegated authority requiring Board approval. The core purpose of the Committee is to support the ALCO in carrying out its responsibilities.
Capital Management Forum (CMF)	The role of the CMF is to review, challenge and monitor the Bank's capital adequacy, in line with capital policy and within risk appetite and review of capital adequacy stress testing. The CMF is responsible for making recommendations to ALCO as appropriate.
Investment Approval Committee (IAC)	The purpose of the IAC is to oversee and challenge the execution of all significant investments, divestments and major capital expenditure proposals as contained within the Bank's turnaround in accordance with the authorities delegated to it by ExCo, ensuring: • that all investments are being made in accordance with the Bank's Five Year Business Plan; • the strategic investment portfolio remains balanced when considering investment demands against scarce resources; • Executive sponsors are empowered to deliver within defined constraints; and • decisions taken are done so in accordance with the requirements of the Risk Management Framework and all applicable Bank PDC Risk Policies and Control Standards.
Project Oversight Committee (POC)	The purpose of the POC is to oversee and challenge the delivery of the Change Portfolio for the Bank, in accordance with the authorities delegated to it by ExCo, ensuring: • there is clarity of delivery outcomes; • that benefits are delivered within agreed time, cost and quality thresholds; • sponsors have the necessary executive support to deliver successfully; and • key risks and issues threatening delivery are receiving the appropriate levels of intervention.

Risk management

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

Risk Management Framework

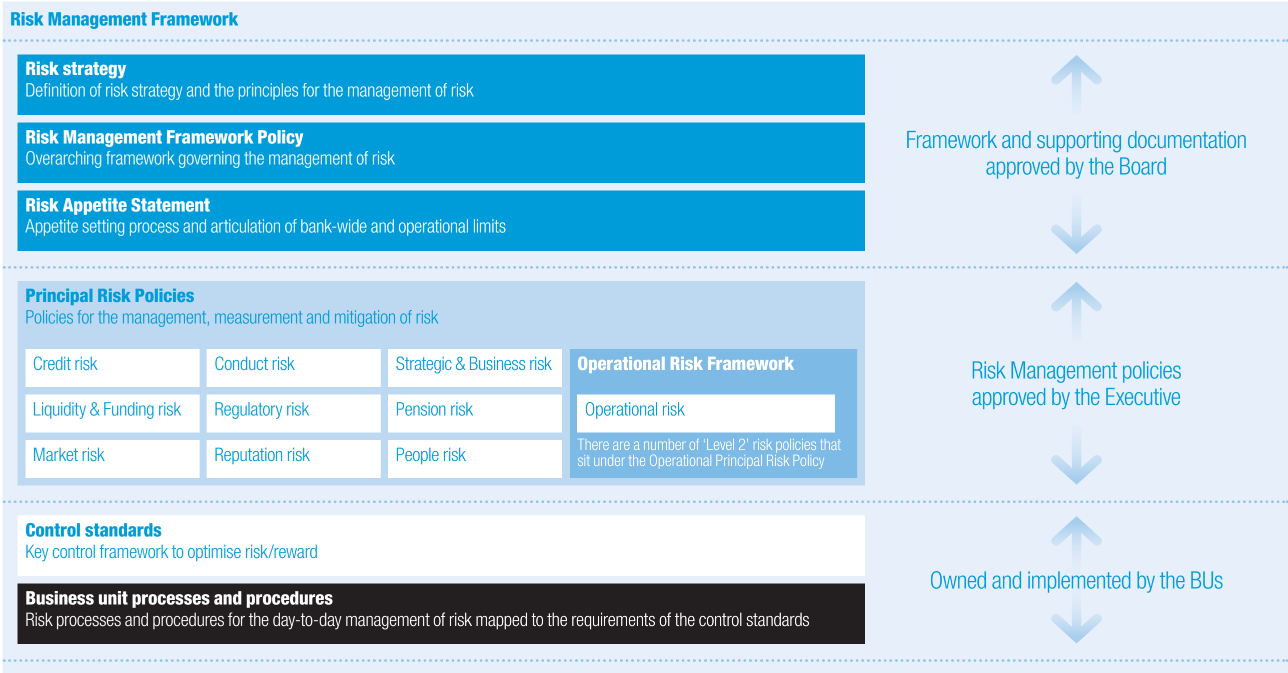
Through the Risk Management Framework the Bank manages enterprise-wide risks, with the objective of maximising risk adjusted returns while remaining within risk appetite.

Underpinning the framework is a set of principles that describe the Bank's risk management culture:

- Balancing risk and return: risk is taken in support of the requirements of our stakeholders, in line with our strategy and within our risk appetite;
- Responsibility: it is the responsibility of all employees to ensure that risk-taking is disciplined and focused. We take account of our social responsibilities and our commitments to customers;
- Accountability: risk is taken only within agreed authorities and where there is appropriate infrastructure and resource. All risk-taking must be transparent, controlled and reported;
- Anticipation: we seek to anticipate future risks and ensure awareness of all known risks; and
- Competitive advantage: we seek to achieve competitive advantage through efficient and effective risk management and control.

The Risk Management Framework articulated below consists of a hierarchy of strategies, policies and standards which are designed to support the Bank's risk-based decision-making.

The Risk Management Framework is under continuous review and will continue to be refined as the Bank embeds it into its day-to-day operations.



Risk strategy and principles

The Bank's overall risk strategy is maintained by the CRO and approved by the Board. The risk strategy sets out the:

- way in which risk management supports the Bank through bringing transparency, clarity and insight;
- strategic goals for risk management across the Bank; and
- risk management principles that must be followed across the Bank in order to achieve those strategic goals.

Risk management continued

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

Risk Management Framework continued

To achieve the strategic goals, the following principles are mandated across the organisation:

- the Board requires the business to be managed in line with the risk strategy which sets out the agreed vision within the agreed risk appetite. Risk, as well as reward, should be taken into account in a consistent way across the business when pursuing all strategic objectives to maintain the desired risk profile;
- the Board is ultimately responsible for all the Bank's risks and approves limits for the business so it may operate within the agreed risk appetite. The Board expects management to realise strategic objectives whilst understanding these limits to build an effective risk culture;
- an independent review and challenge is provided by the CRO who is supported by an appropriate governance structure to implement and continuously improve the Risk Management Framework;
- recognised, emerging or current risks are managed in line with the Bank's approach for identification, measurement, management, monitoring and reporting;
- stress testing exercises are carried out to assess the impact of a range of adverse scenarios with different probabilities and severities to inform the Bank's strategic planning processes;
- management monitors the aggregated risk profile of the Bank and its regulated entities and reviews, trends which are reported to the Board and externally to regulators to meet external obligations; and
- risk management techniques are adopted across the business with the use of these evidenced through documentation and self-certification.

The Bank's risk strategy and Risk Management Framework is under continuous review. Whilst the Bank has started to embed improved risk management processes and procedures it still falls short of best practice and further improvement will continue in 2015.

Risk appetite statement

The Board has primary responsibility for identifying the key business risks facing the Bank, approving the Bank's risk strategy and the acceptable level of risk appetite and associated tolerances, and delegates the setting of the detailed risk limits and tolerances to the CEO. The CEO uses the Executive Committee (ExCo) and Executive Risk Committee (ERC) governance structure to assist in consideration, review and setting of these more detailed risk appetite limits and tolerances. Any escalation or approval goes to Board Risk Committee (BRC).

The Bank's risk appetite framework encompasses five risk appetite 'pillars', which are customer outcomes, capital adequacy, earnings, liquidity & funding and operational control.

Each of the five risk appetite pillars is supported by quantitative measures to ensure that the Bank operates within the expectations of key stakeholders, including its customers, rating agencies and regulators.

The risk appetite review and refresh process is aligned to the annual planning cycle, and tolerances for each of the risk appetite measures are recalibrated against the revised plan.

The agreed measures are discussed on a rotational monthly basis at ERC and BRC. At the end of 2014, the Bank was outside of its long term risk appetite across a number of measures reflecting the current capital position and operational controls (including IT resilience) of the Bank. This continues to be closely monitored and the Bank's Plan envisages moving within risk appetite over the plan period. In order to remain outside shorter term risk appetites, the Board requires a formal risk acceptance to be tabled detailing when and how management will bring the position within risk appetite.

Risk management continued

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

Principal risk profile

The diagram shows the business activities of each of the divisions of the Bank and the Risk Weighted Assets (RWA's) which reside in each division:

The Co-operative Bank plc

Retail

Business Activities

- Deposits
- Credit and lending to retail customers

Loans and advances to customers (£m): 14,529.8

RWAs (£m)

Credit risk: 1,866.6

Operational risk: 753.3

BaCB/Unity Trust Bank

Business Activities

- Lending to SME sector
- Includes Unity Trust Bank

Loans and advances to customers (£m): 818.1

RWAs (£m)

Credit risk: 760.0

Operational risk: 202.2

Treasury/Other

Business Activities

- Cash flow and liquidity management

Credit Risk Balances (£m): 6,501.6

RWAs (£m)

Credit risk: 1,723.8

Operational risk: 35.9

Non-core

Business Activities

- Historic corporate loans
- Closed mortgage book

Loans and advances to customers[1] (£m): 10,352.9

RWAs (£m)

Credit risk: 7,150.0

Operational risk: 140.4

Principal risks are outlined in the principal risks table overleaf

1. Includes loans and advances held for sale of £323.4m – see note 18 for further details.

Risk management continued

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

Principal risk profile continued

The Bank seeks to understand and manage the various risks that arise from its operations in line with the Risk Management Framework described on page 91.

It defines its principal risks as:

Principal risks	The Bank's definition	Page
1. Credit risk	The current or prospective risk to earnings and/or capital arising from a borrower's failure to meet the terms of any contract with the Bank or the various subsidiaries of the Bank or such borrower's failure to perform as agreed.	**95**
2. Liquidity and funding risk	The risk that the Bank's resources will prove inadequate to meet its liabilities as they contractually fall due or as a result of any contingent or discretionary cash outflows that may occur in a stress. It arises from the mismatch of timings of cash flows generated from the Bank's assets and liabilities (including derivatives). Should additional liquidity be required during a time of stress this is likely to result in higher than anticipated funding costs which will negatively impact on retained earnings and therefore capital resources.	**118**
3. Market risk	The risk that the value of assets and liabilities, earnings and/or capital may change as a result of changes in market prices of financial instruments. The majority of the Bank's market risk arises from changes in interest rates which is managed and hedged in line with the Market Risk Policy to minimise earnings volatility.	**123**
4. Operational risk	The risk of loss resulting from inadequate or failed internal processes, people and systems or external events. This encompasses the effectiveness of risk management techniques and controls to minimise these losses. Legal risk including litigation, model risk[1], anti-money laundering and sanctions are also managed within this risk type.	**126**
5. Reputational risk	The risk associated with an issue which could in some way be damaging to the reputation of the Bank. Underlying issues amongst others arising as a result of: (i) the Bank's strategic decisions or business performance; (ii) an operational failure; or (iii) external perception. This may result in a requirement to hold additional liquidity in anticipation of a stress scenario, which is likely to negatively impact retained earnings over time and therefore capital resources.	**127**
6. Strategic and business risk	The risk arising from changes to the Bank's businesses and the environment in which it operates, specifically the risk of not being able to carry out the Bank's business plan and desired strategy. This may result in the Bank having to hold additional capital and/or liquidity. This risk is covered by many areas of capital in Pillar II, specifically execution, concentration and liquidity risk.	**128**
7. People risk	People risk is the risk associated with the recruitment, employment and management of individuals within the Bank. A significant portion of the Bank's cost base is staff costs and so managing this resource within budget is key to cost reduction and therefore to retained earnings.	**129**
8. Regulatory risk	The risk of fines, public censure, limitation on business, requirements for legal or operational restructuring, or restitution costs arising from the failure to understand, interpret, implement and comply with UK and EU regulatory requirements.	**129**
9. Conduct risk	The risk that the Bank's behaviour, offerings or interactions will result in unfair outcomes for customers.	**130**
10. Pension risk	The risk to the Bank's capital and company funds from the Bank's exposure to scheme liabilities (to the extent liabilities are not met by scheme assets) and risks inherent in the valuation of scheme liabilities and assets.	**130**

1. Model risk is a specific operational risk. It is defined as the risk of model failure or the inappropriate use of models resulting in potential loss, poor decision making and/or reputational damage. Due to the size of the risk and the Bank's reliance on models, it is managed by a separate forum, the Model Risk Forum, to ensure sufficient focus is placed on its management.

Risk management continued

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

1. Credit risk

In plain English:

Credit risk is the risk that borrowers will fail to repay what they have borrowed. The risk to the Bank includes the amounts lent not being repaid, loan interest not being received, cash flows being received later than expected and increased collection costs. This results in the need to set aside provisions and capital to provide for future losses.

1.1 Overview

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

Credit policies

Bank-wide credit policies and standards are considered and approved by the ERC, which also oversees the delegation of credit approval and loan impairment provisioning authorities.

Policies and procedures specific to each business are established by authorised risk Committees. These are consistent with Bank-wide credit policies, but are more detailed and adapted to reflect the different risk environments and portfolio characteristics.

Risk measurement

Risk measurement plays a central role, along with the BRC, in informing risk taking and portfolio management decisions. Risk measurement is based on a set of metrics, which are aligned with the Board agreed risk appetite and support the limits framework. These metrics undergo periodic review to assure that they are fit for purpose, are able to recognise both emerging and current risks. Credit risk models are subject to annual review by the MRF.

The Retail division of the Core Bank uses both application and behavioural scoring techniques to rank a customer's risk of default with this, in common with other retail banks, being embedded in the business. The Non-core division, which includes corporate lending, includes a number of specialist models to reflect the embedded credit risk of sectors such as Private Finance Initiatives (PFI) and commercial property. The performance of all rating systems is governed by the IRB Model Working Group with oversight from the MRF.

Credit approval

Major credit exposures to individual counterparties, groups of connected counterparties and portfolio of retail exposures are reviewed and approved by the LCC. The LCC derives its authority from the BRC.

All other credit approval authorities are delegated by the BRC to the SCC.

Risk management continued

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

1. Credit risk continued

1.2 Credit exposure

The following analysis of credit exposure shows:

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

Cash and balances at central banks are credit exposures with the Bank of England and have been excluded from the analysis.

Audited

31 December 2014	Loans and advances to banks	Loans and advances to customers[1]	Investment securities	Derivative financial instruments	Total
Analysis of balance in notes	**17**	**18**	**19**	**20**	
Gross balance	**1,608.4**	**26,240.7**	**4,422.5**	**470.7**	**32,742.3**
Less: allowance for losses	**–**	**(539.9)**	**–**	**–**	**(539.9)**
	1,608.4	**25,700.8**	**4,422.5**	**470.7**	**32,202.4**
Analysis of credit risk exposure					
Not impaired	**1,608.4**	**23,827.2**	**4,422.5**	**470.7**	**30,328.8**
Impaired	**–**	**2,413.5**	**–**	**–**	**2,413.5**
	1,608.4	**26,240.7**	**4,422.5**	**470.7**	**32,742.3**
Credit commitments	**154.9**	**2,905.2**	**–**	**–**	**3,060.1**
Gross credit risk exposure	**1,763.3**	**29,145.9**	**4,422.5**	**470.7**	**35,802.4**
Less: allowance for losses	**–**	**(539.9)**	**–**	**–**	**(539.9)**
Net credit risk exposure	**1,763.3**	**28,606.0**	**4,422.5**	**470.7**	**35,262.5**

31 December 2013 (restated)	Loans and advances to banks	Loans and advances to customers	Investment securities	Derivative financial instruments	Total
Analysis of balance in notes	17	18	19	20	
Gross balance	1,594.4	31,238.5	4,519.4	555.8	37,908.1
Less: allowance for losses	–	(952.4)	(20.0)	–	(972.4)
	1,594.4	30,286.1	4,499.4	555.8	36,935.7
Analysis of credit risk exposure					
Not impaired	1,594.4	27,858.8	4,499.4	555.8	34,508.4
Impaired	–	3,379.7	20.0	–	3,399.7
	1,594.4	31,238.5	4,519.4	555.8	37,908.1
Credit commitments	570.1	3,519.9	–	–	4,090.0
Gross credit risk exposure	2,164.5	34,758.4	4,519.4	555.8	41,998.1
Less: allowance for losses	–	(952.4)	(20.0)	–	(972.4)
Net credit risk exposure	2,164.5	33,806.0	4,499.4	555.8	41,025.7

1. Includes loans and advances held for sale of £323.4m – see note 15 for further details

Impaired and not impaired balances in the tables above are defined in the following sections on retail credit risk, corporate credit risk and investment securities credit risk.

Comparative figures have been restated as described in note 3.

Risk management continued

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

1. Credit risk continued

Fair value adjustments

At the time of the merger of Britannia Building Society with the Bank in 2009, the assets and liabilities of Britannia were acquired at estimated fair values.

For the purposes of internal management reporting of coverage ratios and to better understand peer comparatives, loss provisions are grossed up by the amount of remaining credit fair value adjustments and compared to the gross amounts owed by customers, as shown in the Credit risk management section.

1.3 Credit risk management

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

- 1.3.1 Loans and advances to customers;
- 1.3.2 Investment securities;
- 1.3.3 Loans and advances to banks; and
- 1.3.4 Derivative financial instruments.

1.3.1 Loans and advances to customers

The tables below analyses gross balances by impairment classification. They include credit commitments, impairment provisions, fair value adjustments and a reconciliation to gross customer balances. This is the basis on which the business manages risk.

The decrease in impairment provisions in the year to 31 December 2014 for the Non-core Corporate division was driven primarily by the successful execution of the Non-core deleverage strategy, being driven by deleverage activity and updated collateral values. This is referred to in more detail in the Strategic report.

The Non-core business continues to carry additional impairment risk given the underlying assets, which includes Optimum, a closed book of predominantly interest-only intermediary and acquired mortgage book assets. Worsening economic and market conditions and/or increasing interest rates and/or a fall in house prices could result in the Non-core assets suffering from more than expected impairments which would adversely impact the Bank's operating results and financial position (in particular, its net interest margin) and, in the longer term, its ability to comply with its regulatory capital requirements. The Non-core business' corporate asset book is also relatively concentrated, with the result that a small number of borrowers account for a large proportion of the total loans outstanding. Any significant future impairment of these borrowers would result in a disproportionate impact on the Bank's operating results and financial position. As part of the revised plan, in 2014, the Bank announced its intention to deleverage Optimum.

Risk management continued

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

1. Credit risk continued

Audited

	Core				Non-core		
	Retail banking			Unity Trust			
31 December 2014	**Secured**	**Unsecured**	**BaCB**	**Bank**	**Corporate**	**Optimum**	**Total**
Analysis of balance in note 18							
Gross loans and advances[1]	**13,570.2**	**1,067.9**	**649.1**	**175.2**	**4,400.2**	**6,378.1**	**26,240.7**
Less: allowance for losses	**(2.2)**	**(106.1)**	**(3.6)**	**(2.6)**	**(403.5)**	**(21.9)**	**(539.9)**
	13,568.0	**961.8**	**645.5**	**172.6**	**3,996.7**	**6,356.2**	**25,700.8**
Analysis of credit risk exposure							
Not impaired	**13,424.2**	**931.9**	**622.4**	**165.9**	**3,184.2**	**5,498.6**	**23,827.2**
Impaired	**146.0**	**136.0**	**26.7**	**9.3**	**1,216.0**	**879.5**	**2,413.5**
	13,570.2	**1,067.9**	**649.1**	**175.2**	**4,400.2**	**6,378.1**	**26,240.7**
Credit commitments	**346.3**	**2,013.1**	**249.8**	**44.3**	**251.7**	**–**	**2,905.2**
Gross credit risk exposure	**13,916.5**	**3,081.0**	**898.9**	**219.5**	**4,651.9**	**6,378.1**	**29,145.9**
Less: allowance for losses	**(2.2)**	**(106.1)**	**(3.6)**	**(2.6)**	**(403.5)**	**(21.9)**	**(539.9)**
Net credit risk exposure	**13,914.3**	**2,974.9**	**895.3**	**216.9**	**4,248.4**	**6,356.2**	**28,606.0**
Reconciliation of accounting to customer balances							
Gross loans and advances	**13,570.2**	**1,067.9**	**649.1**	**175.2**	**4,400.2**	**6,378.1**	**26,240.7**
Fair value adjustments	**3.7**	**–**	**–**	**–**	**86.5**	**76.3**	**166.5**
Other accounting adjustments	**(2.9)**	**(42.9)**	**0.2**	**–**	**(65.4)**	**(4.3)**	**(115.3)**
Gross customer balances	**13,571.0**	**1,025.0**	**649.3**	**175.2**	**4,421.3**	**6,450.1**	**26,291.9**

1. Includes loans and advances held for sale of £323.4m – see note 15 for further details

	Core				Non-core		
	Retail banking			Unity Trust			
31 December 2013 (Restated)	Secured	Unsecured	BaCB	Bank	Corporate	Optimum	Total
Analysis of balance in note 18							
Gross loans and advances	15,512.2	1,294.6	840.8	188.2	6,480.6	6,922.1	31,238.5
Less: allowance for losses	(4.5)	(160.2)	(5.8)	(8.0)	(738.4)	(35.5)	(952.4)
	15,507.7	1,134.4	835.0	180.2	5,742.2	6,886.6	30,286.1
Analysis of credit risk exposure							
Not impaired	15,367.2	1,077.7	825.2	167.1	4,502.8	5,918.8	27,858.8
Impaired	145.0	216.9	15.6	21.1	1,977.8	1,003.3	3,379.7
	15,512.2	1,294.6	840.8	188.2	6,480.6	6,922.1	31,238.5
Credit commitments	41.1	2,222.5	399.1	41.6	815.5	0.1	3,519.9
Gross credit risk exposure	15,553.3	3,517.1	1,239.9	229.8	7,296.1	6,922.2	34,758.4
Less: allowance for losses	(4.5)	(160.2)	(5.8)	(8.0)	(738.4)	(35.5)	(952.4)
Net credit risk exposure	15,548.8	3,356.9	1,234.1	221.8	6,557.7	6,886.7	33,806.0
Reconciliation of accounting to customer balances							
Gross loans and advances	15,512.2	1,294.6	840.8	188.2	6,480.6	6,922.1	31,238.5
Fair value adjustments	4.2	–	–	–	97.7	92.3	194.2
Other accounting adjustments	4.6	23.6	29.7	(0.3)	(52.4)	1.8	7.0
Gross customer balances	15,521.0	1,318.2	870.5	187.9	6,525.9	7,016.2	31,439.7

Risk management continued
For the year ended 31 December 2014
All amounts are stated in £m unless otherwise indicated

1. Credit risk continued

Unity Trust Bank is accounted for as a subsidiary of the Bank. It operates its own credit processes as a separate bank, and is not included in the subsequent analysis of credit risk.

Other accounting adjustments include accrued interest, interest fair value adjustments and effective interest rate adjustments.

The disclosures in sections Secured residential credit risk, Unsecured retail credit risk and Corporate credit risk are all based on the gross customer balances in the above tables.

Comparative figures have been restated as described in note 3.

Secured residential credit risk

Acquisition and account management

Mortgages are loans to customers secured by a first charge over a residential property. Mortgages are originated directly to customers via branches, telephone and the internet under the Britannia and The Co-operative Bank brands, and via intermediaries under the Platform brand. In the year to 31 December 2014, 24% (2013: 66%) of mortgages were originated directly and 76% (2013: 34%) through intermediaries.

The Britannia and Co-operative Bank brands only originate prime residential mortgages, while Platform primarily originates a combination of prime residential, almost prime residential and buy-to-let loans.

Historically, these loans have been advanced on a capital and interest payment basis, where the loan is repaid over the term of the loan, or interest only, where the capital element of the loan is repayable at the end of the term. All new advances are on a capital repayment basis, with the exception of buy-to-let lending and existing interest only loans for customers moving home.

During the term of the mortgage, interest only mortgages are managed consistently with capital and repayment mortgages. In addition, the Bank determines if the customer has a satisfactory repayment strategy in place on loan maturity, in line with our customer contact strategy. The table below shows residential mortgage completions in the year, analysed by loan-to-value (LTV) and repayment method:

Audited

	2014			2013		
	Amount advanced	**Average LTV %**	**Interest only %**	Amount advanced	Average LTV %	Interest only %
Retail prime	**291.7**	**56.2**	**1.1**	1,416.1	62.6	1.8
Platform prime	**771.3**	**67.4**	**–**	607.2	68.7	–
Total prime	**1,063.0**	**64.0**	**0.3**	2,023.3	64.6	1.3
Buy-to-let	**169.7**	**65.0**	**86.8**	128.1	64.7	86.1
Almost prime	**0.1**	**52.2**	**–**	2.4	52.7	–
Total completions	**1,232.8**	**64.2**	**12.2**	2,153.8	64.5	6.2

A cautious approach to lending, as well as a change to mortgage regulation and time lag between application and completion, led to a significant reduction in completions in the first half of 2014 when compared to 2013. This improved in the latter part of 2014 as discussed in the Strategic report.

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

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

Risk management continued

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

1. Credit risk continued

The table below shows gross customer balances for residential mortgages analysed by types of mortgage and average LTV:

Audited

	31 December 2014				
	Retail secured		Optimum		
	Interest only	Other	Interest only	Other	Total
Less than 50%	**1,294.6**	**4,981.5**	**392.8**	**375.9**	**7,044.8**
50% to 60%	**614.4**	**1,859.3**	**542.4**	**221.8**	**3,237.9**
60% to 70%	**533.2**	**1,929.8**	**940.1**	**250.5**	**3,653.6**
70% to 80%	**238.7**	**1,422.6**	**1,077.2**	**233.8**	**2,972.3**
80% to 90%	**105.1**	**401.4**	**1,060.5**	**151.3**	**1,718.3**
90% to 100%	**73.0**	**64.0**	**723.4**	**50.3**	**910.7**
Greater than 100%	**34.0**	**19.4**	**414.3**	**15.8**	**483.5**
	2,893.0	**10,678.0**	**5,150.7**	**1,299.4**	**20,021.1**

	31 December 2013 (Restated)				
	Retail secured		Optimum		
	Interest only	Other	Interest only	Other	Total
Less than 50%	1,211.0	4,656.3	241.3	291.8	6,400.4
50% to 60%	559.1	1,841.4	268.1	194.9	2,863.5
60% to 70%	855.5	2,151.9	584.7	248.8	3,840.9
70% to 80%	426.9	2,096.8	1,019.4	278.9	3,822.0
80% to 90%	173.7	1,104.2	1,199.1	263.2	2,740.2
90% to 100%	115.1	160.6	1,222.7	149.8	1,648.2
Greater than 100%	95.7	72.8	993.3	60.2	1,222.0
	3,437.0	12,084.0	5,528.6	1,487.6	22,537.2

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

Audited

	31 December 2014					
	< 1 year	1 – 5 years	5 – 10 years	10 – 20 years	20+ years	Total
Retail Secured	**100.7**	**370.0**	**575.3**	**1,436.7**	**410.5**	**2,893.2**
Optimum	**59.9**	**340.7**	**659.5**	**3,870.9**	**219.5**	**5,150.5**
	160.6	**710.7**	**1,234.8**	**5,307.6**	**630.0**	**8,043.7**

	31 December 2013					
	< 1 year	1 – 5 years	5 – 10 years	10 – 20 years	20+ years	Total
Retail Secured	97.0	391.0	608.5	1,717.5	623.0	3,437.0
Optimum	17.9	346.4	616.8	4,260.6	286.9	5,528.6
	114.9	737.4	1,225.3	5,978.1	909.9	8,965.6

Risk management continued

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

1. Credit risk continued

The table below shows gross customer balances for residential mortgages analysed by current LTV banding and repayment method:

Audited

	31 December 2014					
	Retail secured			Optimum		
	Gross customer balance	Average LTV %	Interest only %	Gross customer balance	Average LTV %	Interest only %
Prime residential	**12,658.4**	**50.2**	**16.8**	**566.2**	**76.4**	**75.1**
Buy-to-let	**797.2**	**55.8**	**87.1**	**1,893.1**	**69.3**	**92.9**
Self-certified	**71.7**	**43.4**	**85.6**	**1,701.2**	**71.0**	**79.7**
Almost prime	**42.1**	**48.5**	**29.6**	**770.4**	**83.2**	**72.4**
Non-conforming	**1.6**	**58.8**	**46.5**	**1,519.2**	**73.7**	**69.4**
	13,571.0	**50.5**	**21.3**	**6,450.1**	**73.1**	**79.9**

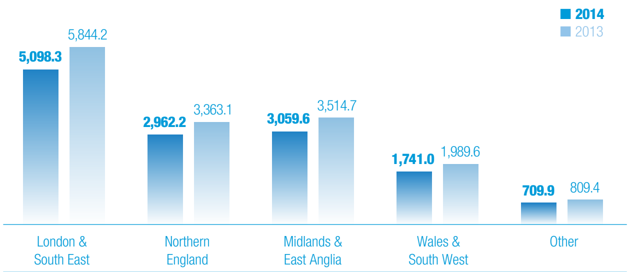
	31 December 2013 (restated)					
	Retail secured			Optimum		
	Gross customer balance	Average LTV % (Restated)	Interest only %	Gross customer balance	Average LTV % (Restated)	Interest only %
Prime residential	14,349.9	55.3	17.1	640.5	84.8	74.1
Buy-to-let	1,032.2	60.1	87.9	2,041.6	77.4	92.2
Self-certified	82.4	49.6	77.0	1,867.1	78.9	78.6
Almost prime	54.3	53.5	30.1	824.6	92.5	71.2
Non-conforming	2.2	66.6	60.5	1,642.4	81.1	68.0
	15,521.0	55.6	22.1	7,016.2	81.1	78.8

Restatement of average LTV in the above table reflects an improvement in calculation methodology from simple average to weighted average.

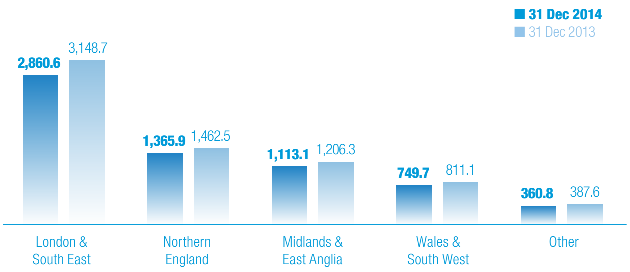
The charts below show gross customer balances analysed by geographical location:

Audited

Retail secured



Optimum



Risk management continued

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

1. Credit risk continued

Collateral

Mortgages are secured by a first charge over the property being purchased or remortgaged. Valuation of the property is normally assessed by a Royal Institution of Chartered Surveyors (RICS) certified surveyor from the Bank's approved panel. Valuations may also be assessed 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. The table below analyses the indexed value of property collateral held against mortgage portfolios:

Audited

	31 December 2014					
	Retail Secured			**Optimum**		
	Gross customer balance	**Collateral**	**Cover %**	**Gross customer balance**	**Collateral**	**Cover %**
Impaired	**146.1**	**145.6**	**99.7**	**955.8**	**942.1**	**98.6**
Not impaired	**13,424.9**	**13,416.6**	**99.9**	**5,494.3**	**5,473.1**	**99.6**
	13,571.0	**13,562.2**	**99.9**	**6,450.1**	**6,415.2**	**99.5**

	31 December 2013 (Restated)					
	Retail Secured			Optimum		
	Gross customer balance	Collateral	Cover %	Gross customer balance	Collateral	Cover %
Impaired	149.0	148.3	99.5	1,095.9	1,062.5	97.0
Not impaired	15,372.0	15,356.1	99.9	5,920.3	5,866.2	99.1
	15,521.0	15,504.4	99.9	7,016.2	6,928.7	98.8

In the table, collateral is constrained to a maximum of 100% of the exposure to each customer to correctly reflect the maximum protection available to the Bank.

Impairment

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 (ie where a loss event has occurred, but objective evidence of impairment has not yet been identified).

Certain loans are separated into discrete pools for the assessment of potential impairment, which has not been specifically identified but which we know has occurred due to specific conditions. These are:

- those loans which are in arrears by less than one monthly instalment; and
- those loans where there has been a material deterioration in the borrower's external credit score in the last 12 months.

For each loan assessed for impairment, whether identified or unidentified, a shortfall is calculated based on the difference between the current loan balance and the expected 'forced sale' price of the 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.

Risk management continued

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

1. Credit risk continued

The table shown below reports coverage ratios calculated using:

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

Audited

	31 December 2014		31 December 2013 (Restated)	
	Retail secured	**Optimum**	Retail secured	Optimum
Gross loans and advances	**13,570.2**	**6,378.1**	15,512.2	6,922.1
of which impaired	**146.0**	**879.5**	145.0	1,003.3
Impaired as a % of gross loans and advances	**1.1%**	**13.8%**	0.9%	14.5%
Allowance for losses	**2.2**	**21.9**	4.5	35.5
Coverage	**1.5%**	**2.5%**	3.1%	3.5%

Comparative figures have been restated as described in note 3.

The movement in Optimum impairment provisions in the year to 31 December 2014 was driven by a combination of improvements in forecast house price movements reducing the anticipated shortfalls on properties expected to roll into default, and a reduction in overall asset levels as a result of the run-off of the portfolio, hence reducing the overall allowance for losses required.

The Bank manages recovery of customer arrears on a gross customer balance basis (excluding credit fair value adjustments and other accounting entries). Gross loans and advances to customers comprise mortgages that were acquired by the Bank at discounts to the amounts that were advanced to the mortgagors (including the whole of the Optimum portfolio), and mortgages that were originated by the Bank.

In order to aid comparability with its peers, and for internal management reporting purposes, the Bank also calculates allowance for losses on the basis of amounts originally advanced to mortgagees, regardless of whether the Bank acquired or originated these mortgages. On this basis the retail secured allowance for losses is £5.9m (2013: £8.7m) and the coverage ratio is 4.0% (2013: 5.8%) and the Optimum allowance for losses is £98.2m (2013: £127.8m) and the coverage ratio is 10.3% (2013: 11.7%).

The Bank has refined its approach to include a calculation of coverage ratios by reference to 90+ days past due and default balances. On this new basis:

- the retail 90+ days past due and default balance is £46.7m (2013: £53.1m), 0.3% of total customer balances (2013: 0.3%) and the coverage ratio is 12.7% (2013: 16.4%); and
- the Optimum 90+ days past due and default balance is £473.2m (2013: £579.9m), 7.3% of total customer balances (2013: 8.3%) and the coverage ratio is 19.8% (2013: 22.0%).

The fall in coverage ratios in 2014 is due to changes in the Housing Price Index through the year, this has reduced the Bank's anticipated future incurred loss expectations and consequently reduced the allowance for losses held.

Risk management continued

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

1. Credit risk continued

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

Audited

	31 December 2014	
	Retail secured	**Optimum**
Balance at start of year	**145.0**	**1,003.3**
Classified as impaired during the year	**67.5**	**221.5**
Transferred to unimpaired during year	**(40.6)**	**(311.3)**
Net repayments and other	**(25.9)**	**(34.0)**
Balance at the end of year	**146.0**	**879.5**

This table is based upon information used for management purposes.

The table below shows the credit quality of customer balances that are not impaired:

Audited

	31 December 2014			31 December 2013 (Restated)		
	Retail secured	**Optimum**	**Total**	Retail secured	Optimum	Total
Low to medium risk	**13,155.0**	**4,153.3**	**17,308.3**	15,084.5	4,438.2	19,522.7
Medium to high risk	**269.9**	**1,341.0**	**1,610.9**	287.5	1,482.1	1,769.6
	13,424.9	**5,494.3**	**18,919.2**	15,372.0	5,920.3	21,292.3

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%. All PDs are calculated using the Internal Ratings Based (IRB) approach under Basel III.

Modelling of credit risk impairment is complex and 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 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 temporary 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 in a manner which is affordable to the borrower.

A number of options are available to borrowers in financial difficulty. Repossession of the property will only be considered when all other avenues have been explored. The precise treatment selected depends on the borrower's individual circumstances, but may include:

- arrangements to repay outstanding arrears over a period of time, by making payments above the contractual amount. The loan is deemed to be impaired until the arrears have been cleared in full;
- short term concessions, where the borrower is allowed to make reduced repayments (or, in exceptional circumstances, no repayments) on a temporary basis to assist with a short term financial hardship. In these cases the shortfall on the repayments will accrue as arrears and the loan is deemed to be impaired;
- whilst permanent or temporary conversion to interest only repayments is no longer granted, where this has been agreed in the past two years, a loan is considered to have been subject to forbearance;
- an extension to the mortgage term to reduce the borrower's repayments. All loans that have had a term extension in the last two years are considered to have been subject to forbearance, even where these were not agreed as a forbearance treatment;
- capitalisation, where outstanding arrears are added to the capital value of the loan to be repaid over the remaining term. This is only considered by exception, with nine cases capitalised during the year to 31 December 2014 (2013: nine); and
- where applicable we will work with the customer as part of a government support scheme. In this case, unmet loan payments which remain in default will continue to accrue as arrears until such time as the loan is cleared, or the outstanding payments are brought up to date.

Mortgages subject to forbearance are assessed to determine the appropriate impairment treatment.

Risk management continued

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

1. Credit risk continued

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

Unaudited

	31 December 2014				31 December 2013 (Restated)			
Retail secured	**Neither past due nor impaired**	**Impaired**	**Loans subject to forbearance**	**Impairment coverage**	Neither past due nor impaired	Impaired	Loans subject to forbearance	Impairment coverage
Concessions	**5.8**	**4.5**	**10.3**	**–**	5.1	8.3	13.4	(0.2)
Arrangements	**14.2**	**18.7**	**32.9**	**(0.4)**	43.3	38.9	82.2	(0.7)
Term extensions	**123.7**	**0.4**	**124.1**	**(0.3)**	335.9	1.0	336.9	(1.2)
Assisted Voluntary Sale	**–**	**0.4**	**0.4**	**–**	–	–	–	–
Interest only switches	**8.3**	**0.8**	**9.1**	**(0.2)**	31.2	1.2	32.4	(0.4)
Capitalisations	**0.1**	**–**	**0.1**	**–**	0.3	–	0.3	–
	152.1	**24.8**	**176.9**	**(0.9)**	415.8	49.4	465.2	(2.5)

	31 December 2014				31 December 2013 (Restated)			
Optimum	**Neither past due nor impaired**	**Impaired**	**Loans subject to forbearance**	**Impairment coverage**	Neither past due nor impaired	Impaired	Loans subject to forbearance	Impairment coverage
Concessions	**8.4**	**8.2**	**16.7**	**(0.3)**	8.9	21.6	30.5	(1.0)
Arrangements	**47.9**	**121.9**	**169.6**	**(7.6)**	91.8	194.3	286.1	(13.9)
Term extensions	**7.2**	**0.3**	**7.5**	**(0.1)**	19.7	0.2	19.9	(0.2)
Assisted Voluntary Sale	**0.1**	**1.1**	**1.2**	**(0.1)**	–	–	–	–
Interest only switches	**3.7**	**1.2**	**5.0**	**(0.2)**	7.7	2.4	10.1	(0.3)
Capitalisations	**0.1**	**0.1**	**0.2**	**–**	0.4	–	0.4	–
	67.4	**132.8**	**200.2**	**(8.3)**	128.5	218.5	347.0	(15.4)

The reduction in the level of forborne balances between December 2013 and December 2014 reflects adoption of the Bank's latest forbearance policy.

The table has been re-presented to reflect reporting consistent with the Bank's forbearance policy. The forbearance policy distinguishes between payments received through forbearance activity and those where a court order has been obtained, with court orders excluded from this re-statement. Secondly, accounts subject to forbearance are reported as forborne for a minimum duration of 12 months.

The Bank is subject to a skilled persons review with respect to potential customer detriment caused by over-forbearance and mortgage arrears handling. Please refer to note 2 describing the related conduct provision.

Unsecured retail credit risk

Acquisition and account management

The Bank offers unsecured lending through loans, credit cards and overdrafts. 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.

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

Audited

	31 December 2014	Restated 31 December 2013
Loans	**436.7**	570.8
Professional and career development loans	**84.8**	82.5
Credit cards	**2,248.6**	2,508.8
Overdrafts	**310.9**	355.0
	3,081.0	3,517.1

Risk management continued

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

1. Credit risk continued

Impairment

Impairment provision is raised for:

- identified impairment – at one penny, one day past due or in excess, based on the probability of default and the discounted cash flow of recoveries from default;
- 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; and
- loans meeting the individually significant asset definition are individually assessed for impairment.

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

Audited

	31 December 2014	Restated 31 December 2013
Gross loans and advances	**1,067.9**	1,294.6
of which impaired	**136.0**	216.9
Impaired as a % of gross loans and advances	**12.7%**	16.8%
Allowance for losses	**106.1**	160.2
Coverage	**78.0%**	73.9%

The movement in unsecured impairment provisions in the year to 31 December 2014 was driven primarily by the execution of a debt sale of impaired assets from the current account and credit card portfolios.

Forbearance

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.

Corporate credit risk

Acquisition and account management

The Bank operates to a lending policy which is subject to meeting criteria as laid down in the corresponding sector strategy guidelines and strict policy with regards to single name and sector concentrations. First line relationship managers submit recommendations for any new money, renewal of facilities or amendments to existing lending to the appropriate sanctioning authority. The supporting credit underwriting team, which is independent from income generation, shall review and risk assess the proposals before submitting recommendations to the sanctioning authority for approval. The credit underwriting team uses rating systems and other tools to analyse the underlying business and the counterparty's management to assess the risk of each lending proposition and its ability to repay the borrowing. Other factors considered include the potential impact of economic changes, availability of supporting collateral, the financial stability of the counterparty and its ability to withstand such change.

The lending discretions for new money are made by the LCC (mainly Non-core customers due to their size), the SAR groups (Non-core only) or the SCC (Core business). The CRO, the Finance Director and the CEO are members of the LCC. The CoAM strategy is executed through higher risk (default and watchlist) and performing SAR groups comprising of first and second line business and credit risk representatives where the majority of decisions are taken to set run-off or exit strategies. On occasion these strategies do require additional lending to protect value in the work out of a customer asset. Beyond certain levels of exposure and/or new money, the SAR group makes recommendations to the LCC for the fund decision.

Monitoring of portfolios and impairment provisioning governance is in place across the portfolios. Individual cases which show signs of unsatisfactory performance are managed through the SAR process to restore them to good health or, wherever this is not possible, take actions to effect recovery.

In addition to the first line Operating Committees for BaCB and CoAM, the CRMF and ERC (and by exception the BRC) receive regular reports on the performance of the portfolio.

Risk management continued

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

1. Credit risk continued

The tables below show the distribution of the BaCB and CoAM gross customer balances (including commitments) by sector and risk grade, where PD grades have been mapped to regulatory slotting categories for ease of interpretation in this report.

Audited

31 December 2014	Standardised	Strong	Good	Satisfactory	Weak	Default	Total
BaCB							
Accommodation, food and licensed services	18.7	12.4	5.9	4.5	–	–	41.5
Care	12.5	12.1	18.5	1.6	–	–	44.7
Education	56.5	2.9	3.7	–	–	–	63.1
Financial services	14.2	26.2	13.9	1.2	0.1	–	55.6
Housing associations	2.0	26.7	0.8	0.3	–	–	29.8
Manufacturing	3.9	12.8	4.4	0.9	–	0.1	22.1
Motor trade and garages	0.8	4.9	2.2	0.4	–	–	8.3
Professional services	10.8	7.1	2.1	1.0	–	0.2	21.2
Property and construction:							
Commercial investment	3.5	5.2	146.3	6.4	0.9	1.6	163.9
Residential investment	4.0	0.1	34.7	1.8	–	–	40.6
Commercial development	–	–	6.4	–	–	–	6.4
Residential development	0.5	–	6.6	0.6	–	–	7.7
Public sector entities	0.2	–	–	–	–	–	0.2
Retail and wholesale trade	1.5	49.4	4.7	123.5	–	–	179.1
Services	71.4	12.8	32.5	3.1	0.1	0.3	120.2
Transport, storage and communication	1.8	7.2	0.3	–	–	–	9.3
Utilities	0.1	0.8	–	0.1	–	–	1.0
Business banking	0.3	41.7	6.1	3.4	0.3	0.5	52.3
Other	2.3	2.3	–	0.1	–	–	4.7
Total BaCB	**205.0**	**224.6**	**289.1**	**148.9**	**1.4**	**2.7**	**871.7**

Corporate portfolio comprises of the Core (BaCB) and Non-core (CoAM) portfolios. The criteria for the BaCB portfolio is a combination of a maximum turnover of £25m for a single legal entity (SLE), maximum exposure of £10m at connection level which might comprise of several SLEs that are directly connected or share common directors/collateral and risk rating being good, strong or standardised. BaCB also encompasses charities and co-operatives (irrespective of size).

BaCB seeks further opportunities to lend using the criteria detailed above. The Core portfolio represents 15% of gross customer balances, having seen a reduction in balances during 2014, due to a combination of market inactivity and repayment. The majority of BaCB rated customers are rated as strong or good (59%), with 24% rated via the standardised approach.

The BaCB portfolio represents a number of industry sectors, with larger concentrations evident in both the Property and construction (25%) and Retail and wholesale trade sectors (21%).

The standardised category relates to sectors which for purposes of capital calculations, are not rated with a regulatory approved rating model due to the sector having an insufficient number of customers and/or low defaults. These typically belong to public sector entities, renewable energy sectors, and to the following customer types within other sectors: energy efficiency schemes, leveraged (which are more highly geared businesses, for example, comprising of Management Buy-Outs or firms that have made business acquisitions to expand their operation) of which we have a relatively small portfolio.

Risk management continued

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

1. Credit risk continued

31 December 2014	Standardised	Strong	Good	Satisfactory	Weak	Default	Total
CoAM							
Accommodation, food and licensed services	67.3	20.3	26.7	18.2	13.8	80.0	226.3
Care	62.7	10.1	0.3	30.2	–	42.7	146.0
Education	15.9	10.1	–	0.4	–	0.1	26.5
Financial services	5.2	–	6.1	1.5	–	2.1	14.9
Football clubs	–	19.4	–	–	0.1	1.2	20.7
Housing associations	5.0	866.7	1.0	–	–	0.3	873.0
Manufacturing	1.8	4.1	0.1	0.9	0.1	0.6	7.6
Motor trade and garages	–	10.1	0.1	0.5	0.5	2.1	13.3
PFI	–	76.9	1,094.4	–	–	–	1,171.3
Professional services	9.2	–	8.8	2.3	–	1.8	22.1
Property and construction:							
Commercial investment	1.9	15.2	415.7	44.4	84.7	661.0	1,222.9
Residential investment	1.4	–	51.4	39.1	1.4	102.4	195.7
Commercial development	45.8	–	10.7	7.1	38.9	67.7	170.2
Residential development	0.2	–	3.9	1.5	0.5	7.9	14.0
Public sector entities	117.5	–	–	–	–	–	117.5
Renewable energy	499.8	–	–	–	–	9.3	509.1
Retail and wholesale trade	1.4	1.6	2.7	0.7	0.1	6.4	12.9
Services	22.0	16.9	2.0	7.8	0.6	28.5	77.8
Transport, storage and communication	1.1	0.1	0.7	4.6	–	3.3	9.8
Utilities	7.6	–	0.2	–	–	4.0	11.8
Business banking	–	–	–	–	–	0.2	0.2
Other	0.4	0.1	0.4	–	–	0.1	1.0
Total CoAM	866.2	1,051.6	1,625.2	159.2	140.7	1,021.7	4,864.6
Total BaCB and CoAM	1,071.2	1,276.2	1,914.3	308.1	142.1	1,024.4	5,736.3

The CoAM portfolio represents 85% of Corporate gross customer balances, with 55% of the CoAM portfolio balances being rated as either strong or good. These strong and good balances are driven predominantly by Housing association and PFI customers, which in turn represent 18% and 24% of total CoAM balances. These sectors along with the Property and construction sector are the sectors with the highest concentration of balances within the CoAM portfolio.

The reduction in Corporate CoAM exposures during 2014 reflects continued deleverage and is most evident in the Commercial investment, Housing associations, Services and Accommodation, food and licensed services sectors. This has also reduced exposures in the default category.

Risk management continued
For the year ended 31 December 2014
All amounts are stated in £m unless otherwise indicated

1. Credit risk continued

31 December 2013 (Restated)	Standardised	Strong	Good	Satisfactory	Weak	Default	Total
BaCB							
Accommodation, food and licensed services	14.8	11.1	18.2	4.9	–	–	49.0
Care	20.3	12.4	26.5	0.5	–	–	59.7
Education	45.9	15.0	5.0	–	–	–	65.9
Financial services	11.5	25.6	20.0	0.8	–	0.2	58.1
Housing associations	2.2	33.6	0.8	–	–	–	36.6
Manufacturing	4.3	8.0	13.7	1.8	–	0.4	28.2
Motor trade and garages	1.5	3.8	5.2	–	–	–	10.5
Professional services	21.1	9.9	5.0	0.1	–	0.3	36.4
Property and construction:							
Commercial investment	6.0	9.8	226.6	0.3	–	0.1	242.8
Residential investment	2.9	0.6	55.9	–	–	–	59.4
Commercial development	0.3	0.5	14.3	–	–	–	15.1
Residential development	0.7	1.2	11.3	–	–	–	13.2
Public sector entities	3.6	–	–	–	–	–	3.6
Retail and wholesale trade	2.3	307.8	9.3	0.2	–	–	319.6
Services	98.6	18.3	23.4	1.8	–	0.3	142.4
Transport, storage and communication	1.9	6.6	3.1	0.2	–	–	11.8
Utilities	0.1	1.5	0.3	–	–	–	1.9
Business banking	0.9	40.1	7.4	3.0	0.6	0.1	52.1
Other	5.0	1.9	0.7	–	–	–	7.6
Total BaCB	243.9	507.7	446.7	13.6	0.6	1.4	1,213.9

Risk management continued

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

1. Credit risk continued

31 December 2013 (Restated)	Standardised	Strong	Good	Satisfactory	Weak	Default	Total
CoAM							
Accommodation, food and licensed services	113.7	82.4	107.7	26.1	16.2	221.8	567.9
Care	112.8	1.1	16.8	31.7	2.4	31.6	196.4
Education	29.1	17.9	–	0.6	–	0.1	47.7
Financial services	52.6	33.0	6.2	3.8	–	4.4	100.0
Football clubs	–	32.2	–	0.4	0.1	15.9	48.6
Housing associations	5.3	1,063.0	0.9	–	–	–	1,069.2
Manufacturing	17.9	9.8	6.5	16.0	0.1	6.6	56.9
Motor trade and garages	–	53.7	16.4	1.7	0.7	7.2	79.7
PFI	–	32.4	1,122.3	–	33.4	–	1,188.1
Professional services	35.6	5.5	11.5	10.0	0.2	2.0	64.8
Property and construction:							
Commercial investment	31.1	75.5	722.6	141.8	27.7	1,190.3	2,189.0
Residential investment	3.3	0.1	83.1	54.6	25.6	127.4	294.1
Commercial development	44.0	4.1	107.0	44.9	1.1	79.7	280.8
Residential development	4.9	–	42.3	11.3	2.2	9.0	69.7
Public sector entities	174.2	0.3	–	–	–	–	174.5
Renewable energy	566.9	–	–	–	–	11.2	578.1
Retail and wholesale trade	38.5	7.4	7.2	7.1	1.1	15.1	76.4
Services	109.1	74.0	18.8	21.2	0.5	29.6	253.2
Transport, storage and communication	15.3	3.4	0.6	6.7	–	6.3	32.3
Utilities	17.9	–	0.7	0.1	–	1.5	20.2
Business banking	–	–	–	–	–	0.4	0.4
Other	0.5	0.7	0.2	1.6	–	2.1	5.1
Total CoAM	1,372.7	1,496.5	2,270.8	379.6	111.3	1,762.2	7,393.1
Total BaCB and CoAM	1,616.6	2,004.2	2,717.5	393.2	111.9	1,763.6	8,607.0

Risk management continued

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

1. Credit risk continued

Collateral

The Bank uses various forms of collateral, including guarantees, to mitigate credit risk. Collateral is regularly reviewed to ensure continued effectiveness as part of the credit review process. Property collateral for corporate lending is categorised as security for property development or investment customers (ie 'property' lending) 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 and guarantees (often supported by tangible security, where appropriate, including property, life policies and stocks & shares) and cash cover.

Where exposures are agreed on a secured basis, security cover is recognised only where:

- the security is legally enforceable and is of a tangible nature and type;
- an appropriate, recent and reliable valuation is held; and
- a prudent margin is applied to the valuation, for the type of security involved.

Property valuations are obtained when the facility is first approved and our lending procedures typically require collateral to be revalued every two years or more frequently in higher risk situations (typically annually or when a material change has occurred that is likely to affect the value and/or recoverability of the debt). For sectors such as Housing associations, which have exhibited zero defaults historically, revaluations would be required every three years or more. 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.

In addition, the values held in the Bank's systems are indexed for risk assessment and capital calculation using appropriate regional and asset type indexes where available, otherwise the national average index is applied.

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

Audited

	31 December 2014			31 December 2013 (Restated)		
	Exposure	Collateral	Impairment provision	Exposure	Collateral	Impairment provision
BaCB						
Non-default loans with ≤1 year until refinancing and all defaulted exposures regardless of term						
Less than 50%	**27.4**	**27.2**	**0.1**	34.0	33.8	0.2
50% to 60%	**3.1**	**3.1**	**–**	15.1	15.0	0.1
60% to 70%	**1.7**	**1.7**	**–**	6.7	6.7	0.1
70% to 80%	**–**	**–**	**–**	1.5	1.5	–
80% to 90%	**0.9**	**0.9**	**–**	1.2	1.2	–
90% to 100%	**–**	**–**	**–**	0.9	0.9	–
Greater than 100%	**0.1**	**0.1**	**–**	0.1	0.1	–
Unsecured	**88.5**	**–**	**1.2**	45.3	–	0.4
	121.7	**33.0**	**1.3**	104.8	59.2	0.8
Non-default loans with >1 year until refinancing and all non-loan non-defaulted exposures regardless of term						
Less than 50%	**253.3**	**253.3**	**0.1**	262.8	260.9	1.9
50% to 60%	**87.3**	**87.3**	**–**	155.9	154.8	1.2
60% to 70%	**48.7**	**48.7**	**–**	98.9	98.1	0.7
70% to 80%	**38.3**	**38.3**	**–**	33.0	32.8	0.2
80% to 90%	**11.6**	**11.5**	**–**	60.1	59.8	0.3
90% to 100%	**1.8**	**1.7**	**–**	13.3	13.2	0.1
Greater than 100%	**26.8**	**17.4**	**0.4**	36.2	26.7	0.3
Unsecured	**282.2**	**–**	**1.1**	448.7	–	2.6
	750.0	**458.2**	**1.6**	1,108.9	646.3	7.3
	871.7	**491.2**	**2.9**	1,213.7	705.5	8.1

Risk management continued

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

1. Credit risk continued

Audited

	31 December 2014			31 December 2013		
	Exposure	**Collateral**	**Impairment provision**	Exposure	Collateral	Impairment provision
CoAM						
Non-default loans with ≤1 year until refinancing and all defaulted exposures regardless of term						
Less than 50%	**33.5**	**32.5**	**1.0**	54.6	51.6	3.0
50% to 60%	**72.4**	**70.3**	**2.0**	102.9	80.3	22.6
60% to 70%	**86.5**	**85.8**	**0.7**	165.8	162.9	2.9
70% to 80%	**44.3**	**41.2**	**3.1**	153.6	146.1	7.5
80% to 90%	**106.9**	**89.8**	**17.1**	95.2	73.5	21.7
90% to 100%	**88.4**	**77.8**	**10.6**	68.4	55.6	12.8
Greater than 100%	**576.6**	**311.2**	**227.8**	1,415.3	803.0	548.6
Unsecured	**264.3**	**–**	**193.8**	285.6	–	138.2
	1,272.9	**708.6**	**456.1**	2,341.4	1,373.0	757.3
Non-default loans with >1 year until refinancing and all non-loan non-defaulted exposures regardless of term						
Less than 50%	**361.9**	**361.8**	**0.1**	346.9	344.6	2.3
50% to 60%	**377.4**	**377.4**	**–**	511.7	507.6	4.1
60% to 70%	**543.7**	**542.9**	**0.8**	692.9	687.9	5.1
70% to 80%	**307.1**	**306.5**	**0.6**	527.0	523.8	3.2
80% to 90%	**34.9**	**34.6**	**0.3**	255.4	253.8	1.6
90% to 100%	**96.1**	**92.3**	**3.9**	59.9	59.5	0.4
Greater than 100%	**116.3**	**52.4**	**1.1**	321.2	189.0	2.3
Unsecured	**1,754.3**	**–**	**9.1**	2,336.9	–	17.1
	3,591.7	**1,767.9**	**15.9**	5,051.9	2,566.2	36.1
	4,864.6	**2,476.5**	**472.0**	7,393.3	3,939.2	793.4

The above tables have been re-presented for 2013 as previously only Property and construction sectors were disclosed, the above now discloses all sectors.

Collateral is constrained to a maximum of 100% of the exposure to each customer to correctly reflect the maximum protection available to the Bank.

As at 31 December 2014, £25.4m (2013: £52.3m) of the above collateral is not held as first charge.

Impairment

Corporate customers are placed on a watchlist and treated as impaired when they show signs of unsatisfactory performance and require close monitoring. Strong indicators that a customer should be placed on a watchlist include but are not limited to:

- unsatisfactory account operation – both lending facility and current accounts;
- considerable reduction in value of collateral;
- deteriorating balance sheet position and/or material losses/cash flow pressures;
- breach of covenants;
- refinance risk at maturity;
- application of forbearance strategies; and
- business performance is assessed to have deteriorated to the extent that there is a real risk of loss of principal, interest or fees.

After a period of satisfactory performance, and dependent on the Bank’s agreement that triggers which led to inclusion on the watchlist no longer apply, customers may be removed from the watchlist.

Risk management continued

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

1. Credit risk continued

Removal from the watchlist usually requires the customer's management information to show that trading and account performance is achieving the revised plan with objective evidence that this will continue.

The Bank also reviews on a monthly basis, through the Impairment Charge Forum, all high risk loans (including those accounts subject to forbearance) and considers the potential loss which might arise were the borrowers to fail (notwithstanding that continued trading remains the expectation).

Objective evidence of impairment will include but is not limited to:

- an instalment on a loan account being overdue, or having been in excess of its limit (or being overdrawn without an agreed limit) for 90 days or more;
- an event likely to result in insolvency which may involve bankruptcy, or the appointment of an administrative receiver, liquidator or administrator; or
- if the Bank considers that at some point (normally within the next 12 months) the facility is unlikely to be repaid in full and actions such as an issue of formal demand will be required in order to achieve full repayment.

A credit risk impairment charge is required on some of or the entire shortfall between the security held and the loan balance outstanding and represents an assessment of the likely net loss after realisation of any security.

For credit risk impairment purposes, a property valuation or selling agent's recommendation is discounted to take into account selling and legal costs and also to build in a contingency to cover potential reductions in the selling price based upon the type of security and entity and the existence or otherwise of a contracted sale. In some cases, calculation of the credit risk impairment is based on an up-to-date assessment (often following an independent business review by a firm of accountants) of likely receivables from the business or a formal estimated outcome statement from an insolvency practitioner where the business has failed.

Provisioning adjustments are also recorded, as appropriate, against loans whose interest terms have changed such that revised future cash flows discounted at the original interest rate are less than the current carrying amount.

The Collective Unidentified Impairment Provision (CUIP) provides cover for the non-defaulted portfolio using a formulaic approach based on default experience across the portfolio. This reflects trigger events that have occurred but not yet been identified and cannot therefore be allocated to individual loans.

Audited

	31 December 2014		31 December 2013 (Restated)	
	BaCB	**CoAM**	BaCB	CoAM
Gross loans and advances	**649.1**	**4,400.2**	840.8	6,480.6
of which impaired	**26.7**	**1,216.0**	15.6	1,977.8
Impaired as a % of gross loans and advances	**4.1%**	**27.6%**	1.9%	30.5%
Individual allowance for losses	**1.4**	**386.8**	0.5	698.4
Impairment coverage (excluding collective provisions)	**5.2%**	**31.8%**	3.2%	35.3%
Collective allowance for losses	**2.2**	**16.7**	5.3	40.0

Comparative figures have been restated as described in note 3.

The Bank manages recovery of customer arrears on a gross customer balance basis (excluding credit fair value adjustments and other accounting entries). Gross loans and advances to customers comprise mortgages that were acquired by the Bank at discounts to the amounts that were advanced to the mortgagors, and mortgages that were originated by the Bank. In order to aid comparability with its peers, and for internal management reporting purposes the Bank also calculates allowance for losses on the basis of amounts originally advanced to mortgagors, regardless of whether the Bank acquired or originated these mortgages. On this basis the BaCB allowance for losses is £1.4m (2013: £0.5m) and the coverage ratio is 5.2% (2013: 3.2%) and the CoAM allowance for losses is £473.3m (2013: £796.1m) and the coverage ratio is 38.9% (2013: 40.2%).

Risk management continued
For the year ended 31 December 2014
All amounts are stated in £m unless otherwise indicated

1. Credit risk continued
The movements in impaired customer balances during the year are shown below:

Audited

	31 December 2014		31 December 2013 (Restated)	
	BaCB	CoAM	BaCB	CoAM
Balance at start of year	**15.6**	**1,977.8**	8.6	2,460.9
Classified as impaired during the year	**190.9**	**259.9**	15.6	501.2
Transferred to unimpaired during year	**(57.4)**	**(59.4)**	(0.5)	(3.2)
Amounts written off	**–**	**(178.2)**	–	(246.6)
Net repayments and other	**(122.4)**	**(784.1)**	(8.1)	(734.5)
Balance at the end of the year	**26.7**	**1,216.0**	15.6	1,977.8

Forbearance
If the Bank is confident of a customer's ability and commitment to address their financial difficulties, it may agree to grant concessions to the original contractual terms. Such concessions typically include:

- restructuring, waiving or reserving rights in the event of covenant breaches;
- postponement of principal payments;
- restructures of principal payments;
- extension of loan maturities;
- partial or full capitalisation of interest payments; or
- swap restructures.

In addition to the above, other 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:

Audited

	31 December 2014			31 December 2013 (Restated)		
	Forborne	Non-forborne	Total	Forborne	Non-forborne	Total
BaCB						
Default	**1.5**	**1.4**	**2.9**	–	1.4	1.4
On watchlist	**4.0**	**23.7**	**27.7**	8.8	5.5	14.3
Neither default nor on watchlist	**8.1**	**833.0**	**841.1**	1.9	1,196.1	1,198.0
	13.6	**858.1**	**871.7**	10.7	1,203.0	1,213.7
CoAM						
Default	**418.6**	**607.5**	**1,026.1**	936.5	825.7	1,762.2
On watchlist	**125.4**	**99.6**	**225.0**	116.2	204.8	321.0
Neither default nor on watchlist	**50.4**	**3,563.1**	**3,613.5**	16.3	5,293.8	5,310.1
	594.4	**4,270.2**	**4,864.6**	1,069.0	6,324.3	7,393.3
	608.0	**5,128.3**	**5,736.3**	1,079.7	7,527.3	8,607.0

Impairment provisions are recognised on accounts, which are in default and on the watchlist, subject to forbearance.

Risk management continued

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

1. Credit risk continued

For those customers that benefit from ongoing concessions (such as postponement of principal payments), the Bank retains the forbearance status 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 their occurrence provided that the loan has been kept up to date during that period and all covenants continue to be met.

1.3.2 Investment securities

At the balance sheet date, the Bank has a total investment securities portfolio of £4,422.5m (2013: £4,519.4m) of which £nil (2013: £20.0m) is considered impaired and against which full provisions are held.

The following tables analyse the gross balance by impairment classification and type of investment security:

Audited

	Investment securities			
31 December 2014	**Loans and receivables**	**Available for sale**	**Fair value through income or expense**	**Total**
Analysis of balance in note 19				
Gross balance	**18.1**	**3,167.5**	**1,236.9**	**4,422.5**
Less: allowance for losses	**–**	**–**	**–**	**–**
	18.1	**3,167.5**	**1,236.9**	**4,422.5**
Analysis of credit risk exposure				
Not impaired	**18.1**	**3,167.5**	**1,236.9**	**4,422.5**
Impaired	**–**	**–**	**–**	**–**
Gross credit risk exposure	**18.1**	**3,167.5**	**1,236.9**	**4,422.5**
Less: allowance for losses	**–**	**–**	**–**	**–**
Net credit risk exposure	**18.1**	**3,167.5**	**1,236.9**	**4,422.5**

	Investment securities			
31 December 2013 (Restated)	Loans and receivables	Available for sale	Fair value through income or expense	Total
Analysis of balance in note 19				
Gross balance	23.6	2,752.4	1,743.4	4,519.4
Less: allowance for losses	–	(20.0)	–	(20.0)
	23.6	2,732.4	1,743.4	4,499.4
Analysis of credit risk exposure				
Not impaired	23.6	2,732.4	1,743.4	4,499.4
Impaired	–	20.0	–	20.0
Gross credit risk exposure	23.6	2,752.4	1,743.4	4,519.4
Less: allowance for losses	–	(20.0)	–	(20.0)
Net credit risk exposure	23.6	2,732.4	1,743.4	4,499.4

The allowance for losses in 2013 related to the Bank's holding of both senior and junior subordinated income notes that were sold in the first quarter of 2014.

Risk management continued

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

1. Credit risk continued

Collateral

There are policies in place with regard to the management and valuation of collateral. Repos and secured lending positions are revalued daily and margin calls on collateralised swaps are made dependent on the counterparty. Eligible financial collateral for Basel III reporting purposes typically includes gilts held under reverse repo agreements and cash held under both repo agreements and collateralised swap arrangements. At the year end there were no gilts held under reverse repo agreements. The Bank did hold some non-UK Sovereign bonds as collateral for derivative exposures.

Guarantees relied upon are either parental guarantees held against subsidiary exposures within bank groups or sovereign guarantees.

Impaired assets

Investment securities are considered past due when the contractual interest or principal payments are in arrears and it is determined that the Bank will be able to collect all principal and interest outstanding according to the contractual terms of the agreements.

Investment securities are considered impaired where it is determined that the Bank will be unable to collect all principal and interest outstanding, according to the contractual terms of the agreements.

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

Not impaired assets

The Bank only invests in treasury assets which comply with the Credit Risk Policy and Treasury Credit Risk Control Standard. Within the Treasury investment security portfolio 100% (2013: 100%) of exposures have an external credit rating equivalent to Fitch A or above.

1.3.3 Loans and advances to banks

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

1.3.4 Derivative financial instruments

The Bank enters into collateral agreements to mitigate credit risk from derivative counterparties. The majority of the Bank's collateral agreements are bi-lateral. None of the Bank's derivatives are cleared using a central clearing counterparty. Most derivatives that are subject to collateral agreements are collateralised using cash. Some derivatives linked to funding programmes can place government securities, cash, or other eligible securities as collateral as agreed by rating agencies and subject to ratings triggers.

Occasionally the Bank enters into unilateral agreements for certain derivatives; these are used for credit risk mitigation in securitisation structures.

For non-collateralised derivatives, the Bank uses an internal credit rating approach to adjust fair values for credit risk of the counterparty. The Credit Value Adjustment (CVA) was £3.9m (2013: £4.4m).

Audited

	31 December 2014		31 December 2013 (Restated)	
	Derivative notional (net)	**Derivative fair value (net)**	Derivative notional (net)	Derivative fair value (net)
Interest rate				
Bi-lateral collateral agreements	**12,930.5**	**(399.3)**	15,327.9	(255.7)
One way collateral	**3,005.6**	**(5.0)**	5,078.6	(11.0)
No collateral agreement	**1,049.8**	**165.8**	1,494.9	91.8
Foreign exchange				
Bi-lateral collateral agreements	**440.4**	**(11.7)**	651.3	6.1
One way collateral	**1,058.4**	**169.2**	1,504.3	186.0
No collateral agreement	**0.4**	**–**	–	–
	18,485.1	**(81.0)**	24,057.0	17.2

The above table has been re-presented in order to separately identify one way collateral agreements.

Further disclosures on derivatives is contained in note 20.

Risk management continued

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

1. Credit risk continued

1.4 Wholesale credit risk

The Bank remains a UK focused retail and commercial operation with limited sovereign exposures to Eurozone governments. Limits are in place to manage Treasury credit risk concentrations. These limits are monitored along with related country limits with more granular limits to cover asset class, sector exposures and counterparty groups, to prevent unacceptable concentrations.

As at 31 December 2014 the Bank had a £297m (2013: £299m) gross exposure to the Government of Finland. It held no other material non-UK sovereign debt (2013: £nil).

1.4.1 Direct exposures

During 2014, exposures to financial institutions in European countries were broadly consistent with the year end with a total gross exposure outstanding at 31 December 2014 of £274m (2013: £210m). After credit risk mitigation, the net exposure was £274m (2013: £210m).

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 via a credit risk register. Both the counterparties and assets held are monitored against a Board approved matrix of risk tolerance and associated indicators. The credit risk register is updated for rating actions, market events and financial results as they are announced which may influence a change in risk status and possible escalation requiring management actions and inclusion on the watchlist.

The Treasury risk team reviews the portfolio and watchlists monthly for appropriate risk status bandings and any associated management actions. As at 31 December 2014 there were no red (highest risk) Eurozone exposures outstanding (2013: £nil).

1.4.2 Indirect exposures

Treasury risk management monitoring extends beyond direct risk incurred through counterparty trading to the underlying exposures which Treasury's counterparties may maintain on their own balance sheets. In analysing each counterparty secondary exposure, we assess the vulnerability and impact on that counterparty 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 Treasury's counterparty limits and exposure.

Indirect sovereign exposure exists to the governments of France and Germany through government debt securities held as collateral against a series of currency swaps transacted in support of the Leek 18 securitisation.

Risk management continued

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

2. Liquidity risk Unaudited

In plain English:

Liquidity risk is the risk that the Bank cannot pay amounts that it owes when they fall due, or can only do so at excessive cost. The risk can arise either because:

- the Bank has insufficient funds to pay the amounts it owes; or
- even though the Bank has sufficient funds, those funds have been invested and so are not readily available.

2.1 Overview Unaudited

Liquidity risk arises from mismatches in the timing of cash flows; such as maturities and withdrawals, new lending, and otherwise meet contractual obligations.

The Bank is particularly exposed to any serious loss of confidence by its customers as the majority of the Bank's funding consists of retail and commercial deposits. There is a risk that the availability of these deposits is reduced, or that the cost of replacing the deposits increases to unsustainable levels.

In the year to 31 December 2014 the Bank has increased its liquidity position, with a liquid asset ratio of 17.4% (2013 restated: 16.1%). The Bank has proactively managed its liquidity position, maintaining a regulatory liquidity buffer, and has continued to restructure existing exposures to further improve the funding profile and ensure its financial obligations are met as and when they fall due.

2.2 Liquidity risk management framework Unaudited

The Bank's liquidity risk management framework helps the Bank to manage its liquidity risk, the liquidity risk. It covers the Bank's risk appetite to how liquidity risk is identified, measured, monitored, managed and reported. In addition to this, the Contingency Funding Plan (CFP) is maintained, detailing the procedures and a range of available actions that the Bank could take in the event of a liquidity or funding stress scenario.

The Board expresses its appetite for liquidity and funding risk in its Risk Appetite Statement. ALCO has delegated responsibility for oversight and management of liquidity and funding risks to which the Bank is exposed to the Liquidity Management Forum (LMF).

The liquidity risk appetite is defined with reference to survival periods (which measures the ability of liquid assets and resources to support the Bank if it was to enter a defined stress scenario), adherence to strategic liquidity risk measures and compliance with all regulatory liquidity risk limits.

As per the risk appetite statement defined above the Bank addresses the points raised in the risk appetite statements questions as per the below:

- What constitutes survival?
  The Bank defines survival as ensuring that buffer liquidity never falls below the stressed regulatory minimum requirement. This is a higher benchmark than extinguishing all liquidity (insolvency) as the Board wishes to maintain regulatory confidence that the Bank can always meet its liabilities.

  The Bank analyses two applicable survival periods, one that envisages using contingent liquidity that provides sufficient time for the Bank to assess whether the franchise has altered considerably and further recovery options should be considered. The other survival period only uses liquid assets in ensuring that the Bank has time to raise additional liquidity by the contingency funding detailed within its CFP.

- What is the severity of the stress scenario?
  The framework for the liquidity risk appetite includes provision for a change in the stress scenario, selected from a range of options. The chosen scenario allows ALCO and the Board to most appropriately reflect the liquidity risks facing the Bank in the liquidity risk appetite.

  ALCO and the Board review the internal assessment of the Bank, and set the liquidity requirement for the following 12 month forecast horizon.

Risk management continued

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

2. Liquidity risk continued

2.3 Liquidity risk policies Unaudited

Liquidity risk policies are developed by the Liquidity Management Forum (LMF), ALCO and the Board. The Bank's liquidity management policies are reviewed and approved annually by the BRC (on behalf of the Board) and compliance is reviewed by LMF, ALCO and the Board. The Bank's policy is to have sufficient funds available at all times to meet demands from depositors, to fund agreed advances, to meet other commitments as and when they fall due, and to ensure the Board's risk appetite is met.

The Bank monitors its liquidity position on a daily basis via liquidity risk metrics. The LMF oversees the operational liquidity management and convenes at least once a month. A range of indicators, details of cash flows and media coverage are monitored to attempt to detect early signs of liquidity stress either in the market or events that are specific to the Bank. The LMF, ALCO and the Board discuss the actual liquidity position and projected position incorporating business plans. More frequent meetings are held if necessary, ie when the markets have a heightened period of stress or liquidity shortage. In the event that the CFP is deployed following endorsement from ALCO, then the CEO will convene the Crisis Management Team (CMT) which will become the main management Committee that assumes responsibility for delivering the CFP, engaging other business areas of the Bank and third parties.

The liquidity position is reported at least monthly to ALCO and the Board. The Bank also monitors the adequacy of its controls to provide assurance that liquidity risk is being appropriately managed, and regularly assesses its funding position. The Bank's Liquidity Management Framework is designed in line with FCA and PRA BIPRU regulations and industry guidelines. This will further be updated to reflect the changing European regulation.

The Bank has implemented metrics to control the composition of liquidity resources, which is designed to manage the risk of concentrated cash flow maturities.

The strategic measures approved by the Board include:

- customer loan/deposit ratio, 96% (2013: 95%) – the ratio of customer loans to customer deposits;
- encumbrance ratio, 27% (2013: 27%) – the ratio of assets used in secured funding and long term repurchase agreements divided by total assets; and
- internal liquidity stress tests – the survival period of the Bank under an applicable stress scenario.

In the year to 31 December 2014, the Bank increased its liquid asset ratio to 17.4% at the balance sheet date (2013 restated: 16.1%). This liquid asset ratio improvement is due to a reduction in total assets, this has yet to be offset by reduction in liabilities. The Bank continues to proactively manage its liquidity position, above its own liquidity risk appetite. Liquidity levels are expected to reduce in 2015 in line with its own liquidity risk appetite measure.

2.3.1 Liquid asset portfolios

Total liquidity resources as at 31 December 2014 were £12,120.4m (2013: £11,193.4m). The table below analyses the Bank's liquidity portfolio by product and unencumbered liquidity value. Primary liquidity is liquid assets that are eligible under BIPRU 12.7 and total liquidity is all other liquid assets, including self-issued retained securitisations (contingent liquidity portfolio).

	31 December 2014	31 December 2013
Operational balances with central banks	**4,487.4**	5,076.3
Gilts	**1,246.7**	789.5
Central government and multilateral development bank bonds	**819.5**	1,112.2
Total primary liquid assets	**6,553.6**	6,978.0
Other liquid assets	**14.3**	22.4
Contingent liquidity	**5,552.5**	4,193.0
Total liquidity	**12,120.4**	11,193.4
Average balance	**12,015.8**	9,357.2

The Bank uses any combination of these asset pools to manage liquidity, with primary liquidity used predominantly for short term cash flow movements, while other liquidity is used for creating longer term liquidity. Regular realisation through repo transactions and outright sales provide assurance that these asset pools remain sufficiently liquid. The overall quantum of liquid assets remained stable in 2014 supported by an injection of cash through the capital raising in May 2014. The secondary liquidity portfolio reflects own assets eligible for discounting at central banks, which has increased in 2014.

Risk management continued

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

2. Liquidity risk continued

Funding and liquidity strategy focuses on maintaining a high percentage of liquid assets that are eligible to be included in the LAB. The remaining bonds are set out in the table below:

	31 December 2014	Restated 31 December 2013
Short term deposits	**–**	–
Other public sector securities	**2.5**	2.8
Floating rate notes	**31.0**	2.5
Fixed rate notes	**–**	–
Other securities and commodities	**–**	–
Total non-buffer assets	**33.5**	5.3

2.3.2 Wholesale funding

Wholesale funding is used to supplement retail and commercial deposits by raising longer term funds (over one year in duration) and to diversify the source of funds to support the business plan of the Bank. The Bank has a variety of long term wholesale funding sources outstanding, including securitisations, covered bond and Euro medium-term notes, as shown in the table below:

	31 December 2014	Restated 31 December 2013
Preference shares, PSBs and subordinated debt	**196.4**	196.3
Secured funding	**2,521.8**	4,339.5
Repos	**500.6**	2,119.3
Market borrowing	**46.0**	56.6
MTNs	**832.9**	884.0
Total wholesale funding	**4,097.7**	7,595.7

The reduction of the wholesale funding reflects the repayment of a number of secured funding liabilities in 2014.

The Bank has repo transactions of £500.6m which is secured by own issued retained securitisation notes, which are not recognised on the balance sheet.

The following table sets out the Bank's contractual wholesale funding by maturity:

	31 December 2014	Restated 31 December 2013
Repayable in less than 1 month	**84.8**	2,010.3
Repayable between 1 and 3 months	**324.1**	67.8
Repayable between 3 and 12 months	**389.8**	157.2
Repayable between 1 and 5 years	**580.8**	1,800.8
Repayable in more than 5 years	**2,718.2**	3,559.6
Total external funding	**4,097.7**	7,595.7

The credit rating downgrades by the rating agencies in 2013 have led to sub-investment grade ratings being applied to the Bank's senior debt, leading to a reduction in potential primary and secondary demand for such unsecured instruments.

In response to the Bank corporate downgrade events of 2013, in early 2014 the Bank installed third party back-up servicing and back-up cash management, and other changes into each of its covered bond and securitisation programmes to comply with rating agency criteria. The programme changes were effected through successful noteholder consent exercises and preserved the prevailing covered bond and securitisation programme note ratings. In February 2014, Moody's confirmed the current ratings of all securitisation programme notes (removing the review for downgrade statuses), with the exception of the Leek Finance Number Eighteen class Ca and Cc notes (which remained on review for downgrade due to the cross currency derivative counterparty to which this transaction maintains exposure).

Risk management continued
For the year ended 31 December 2014
All amounts are stated in £m unless otherwise indicated

2. Liquidity risk continued

2.4 Liquidity gap

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 runoff of customer assets and liabilities over time are estimated. The assumptions used to create these estimates and the estimates themselves are approved by ALCO as part of its responsibility to approve the Bank's financial plans.

Gross cash flows include interest and other revenue cash flows. The following table is an analysis of gross undiscounted contractual cash flows of financial assets and liabilities held at the balance sheet date:

31 December 2014 Contractual cash flows	Carrying value	Gross nominal flow	Less than 1 month	1–3 months	3–12 months	1–5 years	Over 5 years
Assets							
Cash and balances at central banks	4,765.3	4,765.3	4,765.3	–	–	–	–
Loans and advances to banks	1,608.4	1,608.4	1,238.4	370.0	–	–	–
Loans and advances to customers [1]	25,849.3	33,816.8	947.2	308.6	1,520.9	8,193.7	22,846.4
Investment securities							
Loans and receivables	18.1	21.8	–	–	0.1	0.6	21.1
Available for sale	3,167.5	3,366.2	89.1	166.9	117.4	1,703.8	1,289.0
Fair value through income or expense	1,236.9	1,268.6	1.5	9.0	66.8	1,166.1	25.2
Derivative financial instruments	470.7	766.3	10.9	13.1	48.2	370.8	323.3
Other assets	466.7	–	–	–	–	–	–
Total recognised assets	37,582.9	45,613.4	7,052.4	867.6	1,753.4	11,435.0	24,505.0
Liabilities							
Deposits by banks	615.4	619.9	103.9	336.8	2.9	176.3	–
Customer accounts	29,614.0	29,974.1	19,117.1	933.6	7,130.5	2,606.2	186.7
Customer accounts – capital bonds	263.8	213.7	8.4	59.2	86.4	59.7	–
Debt securities in issue	3,443.6	4,379.3	94.2	745.3	478.5	2,400.8	660.5
Derivative financial instruments	551.7	1,088.4	14.1	26.4	123.5	390.4	534.0
Other borrowed funds	196.4	410.1	1.9	4.5	17.1	90.8	295.8
Other liabilities	883.5	–	–	–	–	–	–
Total recognised liabilities	35,568.4	36,685.5	19,339.6	2,105.8	7,838.9	5,724.2	1,677.0
Unrecognised loan commitments	3,017.5	3,017.5	2,872.6	85.3	–	59.6	–
Total liabilities	38,585.9	39,703.0	22,212.2	2,191.1	7,838.9	5,783.8	1,677.0

1. Includes loans and advances held for sale of £323.4m – see note 15 for further details.

Risk management continued

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

2. Liquidity risk continued

31 December 2013 Contractual cash flows (Restated)	Carrying value	Gross nominal flow	Less than 1 month	1–3 months	3–12 months	1–5 years	Over 5 years
Assets							
Cash and balances at central banks	5,418.8	5,418.8	5,418.8	–	–	–	–
Loans and advances to banks	1,594.4	1,594.4	1,594.4	–	–	–	–
Loans and advances to customers	30,392.4	44,312.3	1,419.0	452.9	2,810.1	11,852.5	27,777.8
Investment securities							
Loans and receivables	23.6	28.4	7.0	0.1	0.1	2.9	18.3
Available for sale	2,732.4	3,137.3	67.9	137.0	101.9	1,092.4	1,738.1
Fair value through income or expense	1,743.4	1,890.1	6.6	13.7	198.4	1,637.0	34.4
Derivative financial instruments	555.8	265.8	2.0	7.7	26.7	23.7	205.7
Other assets	923.0	–	–	–	–	–	–
Total recognised assets	43,383.8	56,647.1	8,515.7	611.4	3,137.2	14,608.5	29,774.3
Liabilities							
Deposits by banks	2,757.5	2,991.9	1,833.0	41.2	153.3	964.4	–
Customer accounts	32,463.3	33,349.4	21,144.6	1,796.5	2,213.3	8,195.0	–
Customer accounts – capital bonds	538.1	536.4	10.2	94.7	146.4	285.1	–
Debt securities in issue	4,207.6	5,391.0	75.4	34.1	628.1	3,964.0	689.4
Derivative financial instruments	538.6	1,031.2	13.7	34.5	106.6	354.4	522.0
Other borrowed funds	196.3	433.6	–	5.7	17.0	91.0	319.9
Other liabilities	913.9	–	–	–	–	–	–
Total recognised liabilities	41,615.3	43,733.5	23,076.9	2,006.7	3,264.7	13,853.9	1,531.3
Unrecognised loan commitments	4,003.6	4,003.6	3,578.5	–	–	425.1	–
Total liabilities	45,618.9	47,737.1	26,655.4	2,006.7	3,264.7	14,279.0	1,531.3

Comparative figures have been restated as described in note 3.

2.5 Encumbrance

An asset is defined as encumbered if it has been pledged as collateral against an existing liability or to collateralise an exposure that the Bank may have, restricting access to that asset in the event of resolution or bankruptcy. An encumbered asset would be no longer available to the Bank for use in secure funding, to satisfy collateral needs or to be sold to reduce the funding requirement.

	Encumbered	**Unencumbered**
Cash and other liquid assets	**–**	**4,765.3**
Investment securities	**1,644.5**	**2,778.0**
Loans[1]	**6,959.3**	**20,498.4**
Other assets	**–**	**937.4**
	8,603.8	**28,979.1**

1. Includes loans and advances held for sale of £323.4m – see note 15 for further details.

Risk management continued

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

3. Market risk

In plain English:

Market risk is the risk of losses arising due to changes in market prices. The Bank's biggest exposure to market risk is from changes in interest rates. The Bank also has a small exposure to market risk from changes in foreign currency exchange rates.

3.1 Overview

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

The main source of market risk within the Bank is driven by mismatches between the repricing profiles of asset and liability customer products and certain characteristics embedded within these products and basis risk. The Bank no longer has a trading book although the Treasury function does create both market risk and currency risk through its various portfolio management activities.

3.2 Market risk management framework

Market risk is the responsibility of the Treasurer; delegated on a day-to-day basis to Asset and Liability Management (ALM) and Treasury Risk, who are responsible for monitoring current and emerging market risks, and for ensuring compliance with the Bank's market risk appetite. The Treasury Markets team is responsible for managing the Treasury portfolios and carrying out hedging activities to minimise interest rate risk exposure. Treasury ALM department ensures that the other interest rate risk in the banking book (IRRBB) is identified, modelled, reported, monitored and hedged effectively.

3.3 Market risk appetite

The Bank's primary objective is to minimise the sensitivity at product, balance or business level of net interest income and its economic value of its equity base to changes in interest rates. This is translated into a maximum amount of capital that the Bank deems necessary to hold to support the level of market risk exposure and the risk that those exposures may pose to the Bank's future financial performance.

The Bank assesses each of the market risk drivers and establishes a set of limits. In order to quantify the amount of capital the Bank requires against each source of market risk an internal assessment of a rate stress based on historical interest rate data is applied to the limit position. In this context the market risk appetite is expressed as an overarching amount of capital at risk. The overarching risk appetite is underpinned by a number of primary and secondary risk metrics. Primary risk metrics are set against each of the key drivers of market risk and adherence to these limits is central to maintaining market risk within overall appetite. Secondary risk metrics are also used which provide operational early warning indicators which may impact exposure which is assessed via primary risk metrics.

3.4 Primary risk metrics and sources of market risk

The key drivers of market risk that the Bank faces and the metrics used to manage those risks are:

Interest rate risk

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

A key assumption within the calculation of the PV01 is the treatment of the non-interest bearing balances. The Bank periodically analyses its portfolio of non- interest bearing, non-maturity deposits in order to identify a stable 'core' element compared to the more volatile and transitory balances. A behavioural duration is applied to the former while the latter 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 approved by the Bank's ALCO.

Risk limits are formally calculated at least monthly. Interest rate risk and effectiveness of hedging is monitored daily using gap positions, incorporating new business requirements. Draw down risk, in particular for fixed rate mortgages, is managed through weekly tranche meetings. The Treasury team undertakes hedges for interest rate risk 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 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 is based on historical rate movements and captures the period of stress which commenced in 2007. 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 by BMRF and ALCO monthly with action taken as required.

Risk management continued

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

3. Market risk continued

Swap spread risk

Swap spread risk is defined as the risk between the fixed rate element of the swap agreement and the benchmarked treasury instrument that the organisation is exposed to.

The Bank manages swap spread risk by calculating on a daily basis the sensitivity of its hedged fixed rate bond portfolio to a one basis point divergence in yields between the fixed rate bond and its hedge (PV01).

Foreign exchange risk

The Bank's exposure to foreign exchange risk is limited to customer hedging transactions and positions entered via natural customer flow only. Therefore, to manage this risk an overall maximum notional net sterling position limit is set for both intra-day and overnight exposures. This is supported by applying sub-limits to currencies by tier to reflect their liquidity.

Other sources of market risk

- Directional risk – The sensitivity to the overall direction of interest rate movements;
- Yield curve risk – The sensitivity to the relative movement of interest rates at different maturities on the yield curve;
- 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 eg caps, floors, swaptions;
- 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; and
- Credit spread risk – The sensitivity to changes in the credit spread on wholesale assets.

The table illustrates the PV01, Basis Risk, Swap spread and FX risk metrics on the Bank's balances. The PV01 is primarily driven by the non-sensitive balances offset by corresponding asset or derivative positions. The Basis risk is primarily driven by product mix and product pricing.

	31 December 2014	31 December 2013
Total PV01 (£k)	**(141.4)**	194.7
Average PV01 for the year (£k)	**17.6**	95.0
Maximum PV01 for the period	**167.8**	298.4
Minimum PV01 for the period	**(141.4)**	(56.9)
Average basis risk (% of annual NII)	**4.4%**	4.1%
Swap spread PV01 (£k)	**(1,235.4)**	(1,511.4)
Average swap spread PV01 (£k)	**(1,256.3)**	(1,478.1)
FX notional (£m)	**(0.6)**	(2.4)
Average FX notional (£m)	**(0.1)**	(1.1)
Net greater than 12 month Core Bank gap position	**(1,601.0)**	(802.0)
Average Net greater than 12 month Core Bank gap position	**(1,268.0)**	(376.0)

On 11 December 2014 the Bank signed a sale agreement committing to the disposal of £323m (base purchase price of £313m, which includes accrued interest) of corporate assets. As part of this agreement the Bank also agreed to re-assign a number of derivatives linked to the assets within the agreement at a fixed price. As a result, the Bank unwound the opposing derivatives to protect its economic risk position. On completion of the transaction in 2015, the PV01 position would be c. £200k higher.

Risk management continued

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

3. Market risk continued

3.5 Currency risk Audited

The Bank's Treasury foreign exchange activities primarily involve:

- providing a service in meeting the foreign exchange requirements of customers;
- maintaining liquidity in Euros and US dollars by raising funds and investing these to generate a return; and
- performing limited intra-day trading and overnight positioning in major currencies to generate incremental income.

The table below provides an analysis of the Bank's assets and liabilities by currency in sterling equivalent terms

	31 December 2014					31 December 2013 (Restated)				
	£	**$**	**€**	**Other**	**Total**	£	$	€	Other	Total
Assets										
Cash and balances at central banks	**4,765.3**	**–**	**–**	**–**	**4,765.3**	5,418.8	–	–	–	5,418.8
Loans and advances to banks	**1,550.2**	**31.2**	**26.0**	**1.0**	**1,608.4**	1,520.6	28.3	42.9	2.6	1,594.4
Loans and advances to customers[1]	**25,631.6**	**22.3**	**36.2**	**10.7**	**25,700.8**	30,189.7	28.9	54.8	12.7	30,286.1
Fair value adjustments for hedged risk	**148.5**	**–**	**–**	**–**	**148.5**	106.3	–	–	–	106.3
Investment securities										
Loans and receivables	**18.1**	**–**	**–**	**–**	**18.1**	23.6	–	–	–	23.6
Available for sale	**3,166.7**	**0.8**	**–**	**–**	**3,167.5**	2,732.4	–	–	–	2,732.4
FV through income or expense	**1,236.9**	**–**	**–**	**–**	**1,236.9**	1,743.4	–	–	–	1,743.4
Derivative financial instruments	**470.7**	**–**	**–**	**–**	**470.7**	515.4	–	40.4	–	555.8
Equity shares	**2.8**	**–**	**–**	**–**	**2.8**	5.8	–	–	–	5.8
Investments in joint ventures	**5.3**	**–**	**–**	**–**	**5.3**	4.7	–	–	–	4.7
Investment properties	**2.1**	**–**	**–**	**–**	**2.1**	164.1	–	–	–	164.1
Property, plant and equipment	**67.5**	**–**	**–**	**–**	**67.5**	115.2	–	–	–	115.2
Intangible fixed assets	**103.7**	**–**	**–**	**–**	**103.7**	110.7	–	–	–	110.7
Other assets	**187.3**	**–**	**0.3**	**–**	**187.6**	478.9	–	2.0	–	480.9
Prepayments and accrued income	**12.2**	**–**	**–**	**–**	**12.2**	16.5	–	–	–	16.5
Current tax assets	**0.6**	**–**	**–**	**–**	**0.6**	–	–	–	–	–
Deferred tax assets	**21.0**	**–**	**–**	**–**	**21.0**	25.1	–	–	–	25.1
Assets held for sale	**63.9**	**–**	**–**	**–**	**63.9**	–	–	–	–	–
Total assets	**37,454.4**	**54.3**	**62.5**	**11.7**	**37,582.9**	43,171.2	57.2	140.1	15.3	43,383.8
Liabilities										
Deposits by banks	**601.0**	**–**	**14.4**	**–**	**615.4**	2,730.0	–	27.5	–	2,757.5
Customer accounts	**29,571.2**	**16.8**	**25.0**	**1.0**	**29,614.0**	32,399.7	25.1	36.7	1.8	32,463.3
Customer accounts – capital bonds	**263.8**	**–**	**–**	**–**	**263.8**	538.1	–	–	–	538.1
Debt securities in issue	**1,809.5**	**603.2**	**1,030.9**	**–**	**3,443.6**	2,419.1	628.9	1,159.6	–	4,207.6
Derivative financial instruments	**550.5**	**–**	**1.2**	**–**	**551.7**	519.0	–	19.6	–	538.6
Other borrowed funds	**196.4**	**–**	**–**	**–**	**196.4**	196.3	–	–	–	196.3
Other liabilities	**157.8**	**–**	**–**	**–**	**157.8**	200.9	–	2.0	–	202.9
Accruals and deferred income	**16.0**	**–**	**–**	**–**	**16.0**	54.1	–	–	–	54.1
Provisions for liabilities and charges	**617.5**	**–**	**–**	**–**	**617.5**	549.7	–	–	–	549.7
Current tax liabilities	**0.3**	**–**	**–**	**–**	**0.3**	4.2	–	–	–	4.2
Deferred tax liabilities	**84.0**	**–**	**–**	**–**	**84.0**	103.0	–	–	–	103.0
Liabilities held for sale	**7.9**	**–**	**–**	**–**	**7.9**	–	–	–	–	–
Total liabilities	**33,875.9**	**620.0**	**1,071.5**	**1.0**	**35,568.4**	39,714.1	654.0	1,245.4	1.8	41,615.3
Net on-balance sheet position	**3,578.5**	**(565.7)**	**(1,009.0)**	**10.7**	**2,014.5**	3,457.1	(596.8)	(1,105.3)	13.5	1,768.5

1. Includes loans and advances held for sale of £323.4m – see note 18 for further details

Comparative figures have been restated as described in note 3.

At 31 December 2014, the Bank's open currency position was £0.6m (2013: £2.4m). The Bank manages its currency positions against both an overall limit and individual currency limits.

Risk management continued

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

4. Operational risk Unaudited

In plain English:

Operational risk is the risk of loss resulting from inadequate or failed processes, people and systems within the Bank or from external events.

4.1 Operational risk framework

The management of operational risk is designed to assist the Bank in understanding its operations in the light of a Board-approved risk appetite, particularly with regards to reducing capital requirements, maintaining the Bank's reputation as a trusted provider of financial services and meeting regulatory expectations. The framework was concluded to be ineffective in early 2013 and continues to be embedded in line with good practice and regulatory guidelines. The revised methods and approaches continue to be embedded within the business and remain under review as to their effectiveness and efficiency.

Operational risks are identified, managed and mitigated through ongoing risk management practices including material risk assessments, risk event reporting, operational loss data analysis, a detailed risk control self-assessment process, monitoring of key risk metrics, and scenario analysis. Significant operational risks are reported through an appropriate governance structure with regular meetings to monitor the development and effectiveness of the Risk Management Framework and the management of significant risks within the Bank.

4.2 Corporate insurance programme

The Bank has a structured insurance programme designed to transfer the impact of specific operational risks in line with the appetite of the organisation and industry best practice. For example:

- insurance of the Bank's buildings and assets;
- protection of revenue in the event of business interruption;
- protection against impacts of financial crime;
- professional indemnity and directors and officers liability cover; and
- motor, employer, product and public liability insurance.

Risk management continued

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

4. Operational risk continued

4.3 Responsibilities

Key executives each have a nominated risk representative at the Operational Risk Forum (ORF), responsible for ensuring the consistent application of the operational risk framework in their division.

Operational risk is considered in a number of distinct themes for internal management, monitoring and reporting; these are as follows:

Operational risk theme	Description
Financial crime risk	The risk of losses resulting from criminal activity relating to fraud or dishonesty, misconduct in, or misuse of information relating to a financial market.
Anti-money laundering risk	The risk that the Bank may be used to facilitate the laundering of the proceeds of crime or the financing of terrorist activity.
Legal risk	The risk that: • the Bank's contractual arrangements with customers, suppliers or other third parties are not enforceable as intended, are enforced against the Bank in an unexpected way or do not operate as expected; • the Bank's assets are not legally protected (eg intellectual property, real property); and • litigation by or against the Bank is not appropriately managed to protect the Bank's reputation and achieve the best outcome.
People risk	The risk associated with the recruitment, employment and management of individuals within the Bank.
Physical assets and security risk	The risk associated with internal and external threats, either deliberate or accidental, against physical assets, employees and customers that could cause financial and/or non-financial losses, damage to or non-availability of Bank assets.
Business continuity planning risk	The risk that the Bank is unable to continue to deliver products or services at acceptable pre-defined levels following a disruptive incident.
Third party suppliers risk	The risk of financial and non-financial loss associated with all third parties relied upon to provide services to functions which support the performance of the Bank.
New product approval risk	The risk in launching new products or modifying existing ones.
Technology risk	The risk of financial and non-financial impacts resulting from the lack of effective IT systems.
Information risk	The risk associated with the theft, loss, corruption, misuse and inadequate quality of business, customer and employee data across the Bank.
Financial reporting risk	The risk of reputational damage, loss of investor confidence and/or financial loss caused by incorrect financial reporting.
Change risk	The risk of change not being implemented successfully (delivery risks) and/or that the change adversely impacts the Bank's risk profile.

A number of the above operational risks are currently outside of longer term risk appetite including anti-money laundering, technology and financial reporting.

The Bank's turnaround involves embedding of processes and technology to remediate these issues, including the IT infrastructure project (see note 41) and a project to improve financial reporting systems and processes.

5. Reputational risk

In plain English:

Reputational risk is the risk of damage to how the Bank's brand and image is perceived by its internal or external stakeholders as a result of its conduct, performance, or the impact of operational failures or other external issues.

Reputational risk is the potential for damage to the Bank, resulting in loss of earnings or adverse impact on market capitalisation as a result of stakeholders taking a negative view of the Bank or its actions.

Reputational risk could arise from the failure of the Bank to effectively mitigate the risks in its businesses including one or more of country, credit, liquidity, market, regulatory, legal or other operational risk. Damage to the Bank's reputation could cause existing clients to reduce or cease to do business with the Bank and prospective clients to be reluctant to do business with the Bank. All employees are responsible for day-to-day identification and management of reputational risk.

Reputational risk may also arise from a failure to comply with environmental and social standards. Primary environmental and social impacts arise through relationships with clients and customers and financing decisions taken.

Risk management continued

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

6. Strategic and business risk

In plain English:

Strategic and business risk is the risk that the Bank's plans cannot be carried out because of changes, either internal to the Company or external (eg recession), in the markets in which it operates.

A failure to successfully implement or a delay in implementing the Bank's turnaround strategy may adversely impact the Bank's business, operating results, financial condition and prospects, its regulatory capital position and its ability to comply with its regulatory capital requirements.

The Bank does not have a track record in successfully executing large scale changes like those contemplated by its plan. There is a risk that this strategy may be unachievable due to the level of complex and overlapping changes required on multiple axes whilst seeking to strengthen the Bank's brand, reputation and customer satisfaction and its relationship with its employees.

The execution of the Bank's strategy has a number of specific risks. More on this can be found in the Principal Risks and Uncertainties section.

Strategy component	Key risk to strategy
Leveraging the Bank's differentiated brand and leading levels of customer satisfaction	The ongoing implementation of significant cost reductions, branch closures, redundancies and the reorientation of the Bank's network may have a negative impact on the Bank's brand, customer service and levels of customer satisfaction and therefore income. There is a risk that the Bank's ownership structure or actions may undermine the Bank's reputation as being more focused on values and ethics than its competitors. Such a reputation has been a competitive advantage for the Bank. Should, as a result of matters relating to The Co-operative Group, the Bank's brand, levels of customer satisfaction or The Co-operative Movement more generally be damaged, this would have a negative effect on the Bank's business, operating results, financial condition and prospects and negatively impact the ability of the Bank to achieve its stated strategy.
Improving revenue in its Core business in the medium term through improved pricing of its products, appropriate re-pricing of existing products towards market rates, growing primary account customers in the Bank's key market segments, cross-selling products and growing the volume of higher margin lending	The Bank may be unable to achieve these improvements in Core Bank revenue as they depend on several factors, including prevailing macroeconomic conditions (including the level of interest rates), the Bank's position relative to its competitors and the ability of Bank employees appropriately to offer products to meet wider customer needs. The Bank may be unable to make the required changes to systems and product designs to attract and retain customers in the numbers required to deliver the revenue improvements.
The Bank's high cost-to-income ratio continues to impact on its profitability and capital position and reducing its cost base remains a priority for the Bank through various management actions	Implementation of significant cost reductions, branch closures, redundancies and reorientation of the Bank's distribution channels may not achieve the targeted cost savings.
Re-engineering of the Bank's processes and IT	The Bank's processes and controls are currently under remediation. The required improvement and re-engineering of the Bank's IT platform and operational process is significant in scale, complexity and cost. Any delays in, or failure by, the Bank to deliver the re-engineering of the Bank's IT platform may result in ongoing risk of technology failure, significant additional investment costs, subject the Bank to further regulatory sanction and impact the Bank's ability to deliver its turnaround strategy.
Deleverage Non-core assets in a controlled manner	The inability of the Bank to deleverage its Non-core assets in a controlled and capital efficient manner may have a negative impact on the Bank's business, operating results, financial condition and prospects, its regulatory capital position and its ability to comply with its regulatory capital requirements. Any greater than expected costs or delays in deleveraging the Non-core assets may divert funding from and adversely impact the growth of the Core business. Execution of the business plan requires market conditions for the reduction of Optimum to remain favourable.

See page 26 for information regarding the regulatory position of the Bank.

Along with the wider banking industry, the Bank must comply with multiple regulatory changes which may add complexity to an already difficult technology and Prudential Change Programme. These regulatory initiatives may also have an impact on systems, processes and product design with potential compliance and investment costs.

Strategic and business risk is managed through ExCo and the Board via consideration of plan progress on a continual basis.

Risk management continued

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

7. People risk

In plain English:

People risk is the risk that the Bank will be unable to operate as planned because the Bank doesn't have enough employees or employees with the appropriate skills.

People risk is the risk associated with inappropriate employee behaviour (such as the risk that employees act outside of the Bank's policies), inadequate people capability (the risk that people do not support business strategy) and frameworks, resulting in customer or financial detriment, and legal or regulatory censure.

Despite progress on retention and recruitment, the Bank is dependent on its Directors, senior management team and skilled personnel and the loss of one or more Directors or members of senior management or the loss of or failure to recruit and retain skilled personnel may have an adverse effect on the Bank's business, operating results, financial condition and prospects and its ability to achieve its strategy.

People risk is managed by the management team and HR and governed by the Executive People Committee.

8. Regulatory risk

In plain English:

Regulatory risk is the risk of fines, public censure, limitation on business, or restitution costs arising from failure to understand, interpret, implement and comply with UK and EU regulatory requirements. Demonstrating compliance with all applicable regulatory requirements or benefiting from forbearance is essential for the Bank to remain in business.

Management of regulatory risk entails on-going compliance with existing obligations and early identification and effective management of changes in legislative and regulatory requirements that may affect the Bank.

The Bank's operations, including its subsidiaries and associates, are subject to a significant body of rules and regulations that are a condition for authorisation to conduct banking and financial services business. These apply to business operations and affect financial returns and include reserve and reporting requirements and prudential and conduct of business regulations. These requirements are set by the European Central Bank and the principal regulatory authorities that supervise the Bank in the jurisdictions in which it operates. The requirements reflect global standards developed by, among others, the Basel Committee on Banking Supervision and the International Organisation of Securities Commissions. They also reflect requirements of, or derived from, EU legislation.

Changes to regulations

As the Bank must comply with wide-ranging legal and regulatory (including liquidity and capital) requirements and supervision, changes to the legal and regulatory environment may result in additional compliance costs (including the raising of further capital and/or liquidity) and diversion of management time and resources. These changes may negatively affect the Bank's business. In addition, failure to comply with these requirements may result in investigations, disciplinary action, fines, reputational damage and the revocation of the Bank's licences, permissions or authorisations which could have a material negative effect on the Bank's business. The regulatory risk team is responsible for identifying and communicating changes to regulation. Adoption of these changes is owned and managed by the first line.

Regulatory risk management

The regulatory risk function is responsible for monitoring and reporting on regulatory risk across the Bank and facilitates production of regulatory and conduct risk reporting to CRRF, ERC and BRC.

Risk management continued

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

9. Conduct risk

In plain English:

Conduct risk is the risk that the Bank's operations will result in unfair treatment of its customers and so the Bank will have to pay compensation.

Conduct risk is the risk that the Bank's behaviours, offerings or interactions may result in unfair outcomes for customers. Its effective management helps build trust with customers and other stakeholders and promotes a fair outcome focused business through the implementation of an appropriate policy and suite of standards properly communicated to trained staff.

The Bank manages conduct risk in a way that is consistent with its overall risk appetite and aligns with its strategy. The concept of conduct risk is in part derived from elements of the FCA's rules and guidance that are concerned with the conduct of business regulation. However, it also encompasses the principle of treating customers fairly and putting customers at the centre of what we do; it is outcome driven. Conduct risk may arise from any aspect of the way the Bank's business is conducted, a key criteria for the Bank being whether the outcome is fair for its customers. When assessing conduct risk there will often be a closely linked regulatory requirement.

At the end of 2014, the Bank has conduct risk provisions of £436.1m, to cover the costs relating to PPI mis-selling, breaches of the technical requirements of the Consumer Credit Act, interest rate swap mis-selling, packaged accounts and other provisions, further detail of which is provided in note 33 to the accounts.

Along with regulatory risk, conduct risk is governed by the CRRF, ERC and BRC.

10. Pension risk

In plain English:

Pension risk is the risk that the Bank will be required to pay more than expected into its employees' pensions schemes in order that the schemes can pay the pensions to which its employees, former employees and retirees are entitled as they fall due.

Pension risk is the potential for loss due to having to meet an actuarially assessed shortfall in the pension schemes in which the Bank participates. The risk assessment is focused on obligations to the major pension schemes, ensuring that the Bank's funding obligation to these schemes is comfortably within financial capacity.

Controls are applied to mitigate these risks and a monthly pension risk report is made to ALCO and ERC to monitor pension risk and decide if further action is necessary. These reports take account of the risk reporting delivered to pension scheme trustees. The Bank is able to engage directly with the Trustees of the Britannia Pension Scheme and can influence the Trustees of Pace through its relationship with the sponsor, The Co-operative Group.

The Finance Director chairs a pension steering group and pension risk is discussed at a number of Executive and Board Committees on a regular basis.

On 20 November 2014, following a detailed review of current pension arrangements, and as part of an extensive review of the risks and costs faced by the business at this time, the Bank announced it was entering into a period of consultation with all Bank contracted colleagues and the Trades Unions relating to proposed pension changes. The consultation period has now ended and the Bank is working through all of the feedback received. Further discussions will be held with the Trades Unions. The final outcome is expected to be known by the end of March 2015. The pension changes are planned to go live towards the end of 2015.

The high level proposed changes include a move to defined contribution pension options for all colleagues for future service and remove all defined benefit options for future service, including ending the link to final pensionable salary for Pace and Britannia Pension Scheme members where that benefit still existed for certain long serving colleagues.

For further information see note 35 of the accounts.

Capital management

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

Unaudited

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

All CRD IV disclosures are shown on a transitional and fully loaded basis except for the leverage ratio which is only calculated on a fully loaded basis. Through its Policy Statement PS7/13, the PRA implemented CET1 deductions and prudential filters in full from 1 January 2014, with the exception of available for sale unrealised gains. The Bank's fully loaded and transitional positions for additional Tier 1 and Tier 2 capital are similar, however minority interests retain a transitional element.

Significant changes to the calculation of own funds as a result of the implementation of CRD IV include:

- allocation of minority interests between Common Equity Tier 1, Tier 1 and Tier 2 capital;
- additional deductions from Common Equity Tier 1 capital;
- introduction of Credit Valuation Adjustment for derivative exposures;
- introduction of Asset Valuation Correlation for exposures to large financial institutions;
- deduction from Common Equity Tier 1 capital or risk weighting of deferred tax assets and significant investments dependent upon thresholds of own funds; and
- introduction of a non-risk based leverage ratio.

During 2014 the Bank has continued to make progress towards improving its capital position and reducing the overall risk profile of the Bank. In 2014 The Co-operative Group injected the planned £313m Common Equity Tier 1 due from the December 2013 LME. A further £400m capital raising, £387m after costs, was completed in May 2014.

- Fully loaded Common Equity Tier 1 ratio has increased to 13.0% as at 31 December 2014 (2013 restated: 7.2%) reflecting an increase in Common Equity Tier 1 of £556.5m and a decrease in Risk Weighted Assets of £2.4bn.
- Fully loaded leverage ratio has increased to 4.3% as at 31 December 2014 (2013 restated: 2.4%) reflecting an increase in Tier 1 of £556.4m and a decrease in exposure of £6.6bn.
- For most of 2014 the Bank was not compliant with its Individual Capital Guidance (ICG), being the PRA's statement as to the regulatory capital (Pillar 2a) it expects the Bank to hold above Pillar 1. On 31 December 2014 the contribution from The Co-operative Group helped move the Bank into ICG compliance, however due to the Bank's ongoing losses, this position should be regarded as a very temporary situation. The Bank met the Pillar I requirement throughout the year.
- The revised plan[1], which has been accepted by the PRA, anticipates that the Bank will meet the 7% CET1 ratio throughout the planning period and will have sustainably meet ICG by the latter part of the planning period. The plan aims to build a sustainable Core Bank and is designed to create a capital buffer by 2019 which would withstand a severe stress scenario equivalent to the 2014 Bank of England stress test.
- The Bank's leverage ratio is expected to be sustainably above 3.0% by the end of the planning period.

1. See page 26 for information regarding the regulatory position of the Bank.

Capital management continued

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

Risks

The Bank faces risks that may adversely impact the ability of the Bank to comply with its regulatory capital requirements, these include:

- worsening economic and market conditions and/or increasing interest rates and/or a fall in house prices could result in the Non-core assets suffering from more than expected impairments which would adversely impact on the Bank's operating results and retained earnings;
- the Bank needs the ongoing acceptance of the PRA regarding its ICG deficit in moving forwards with its plan. To the extent this is not forthcoming or to the extent that the Bank does not perform in line with its plan, additional capital may be required over and above that included in the plan in order for the Bank to remain a Going Concern. This could also be the case if there are increases in regulatory capital requirements as a result of changes to international regulations or other changes to legislation or other market wide regulatory requirements or a change in regulatory risk appetite. The plan assumes additional non-CET1 capital of £400m will be raised within the plan period;
- the inability of the Bank to deleverage its Non-core assets in a controlled and capital efficient manner may have a negative impact on the Bank's operating results and financial position and its regulatory capital position. In addition, any greater than expected costs or delays in deleveraging the Non-core assets may divert funding from and adversely impact the longer term development and growth of the Core business; and
- the inability of the Bank for whatever reason to execute on its plan.

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

Capital stress testing

The Bank uses stress testing as part of its assessment of capital adequacy, and includes stress testing in relation to:

- financial plan;
- ICAAP; and
- annual stress testing exercise.

Stress testing is embedded within the Bank's financial planning process, with stressed scenarios applied to the Bank's base case plan, at least on an annual basis or more frequent where required. This enables the Bank's senior management and Board to assess the plan under adverse scenarios to ensure the plan remains within risk appetite or that appropriate strategic decisions can be taken.

Scenarios capture a magnitude of macroeconomic variables including GDP, interest rates, unemployment, house prices and commercial real estate prices. An example scenario includes Euro sovereign debt concerns and weakening global economic activity, causing UK exports to recede. The Bank also performs stress testing against PRA defined anchor scenarios, as well as its own bespoke scenarios.

Individual business areas prepare business plans as part of the financial planning process. Stress testing models are utilised to stress businesses' plans over a forward looking five year planning horizon.

Stress testing results are prepared on both a pre- and post-management action basis, and compared to both risk appetite and minimum regulatory requirements. Review and challenge of stress testing results are undertaken by the business and the second line of defence, with review through the Bank's Committee structure.

The Bank also undertakes reverse stress testing to assess the point at which the Bank is likely to fail, on both an individual and combined event basis.

The Co-operative Bank was a participant in the Bank of England 2014 UK concurrent stress test of the eight major UK banks and building societies. This was designed specifically to assess resilience to a very severe housing market shock and to a sharp rise or snap back in interest rates. This was not a forecast or expectation by the Bank of England regarding the likelihood of a set of events materialising, but a coherent, severe 'tail risk' scenario.

Results of this exercise were published on 16 December 2014 and can be found on the Bank of England website www.bankofengland.co.uk.

As a result of the stress test, the Bank was required to submit a revised capital plan which was accepted by the PRA in December 2014. This plan is designed to enable the Bank to withstand a severe stress by 2019. As part of the plan, the Bank has committed to reducing its Risk Weighted Assets to £7.5bn by the end of 2018, and will primarily undertake this through reducing the Optimum portfolio which is particularly vulnerable to stress.

Reflecting the current economic conditions, the Bank's risk appetite includes the requirement to hold sufficient capital to meet a mild downturn in activity such as is experienced once in every 10 years; a '1-in-10' stress. The Bank submitted its most recent ICAAP in July 2014. When the ICAAP was prepared, based on 31 December 2013 data, the Bank forecast remaining above the 4.5% CET1 minimum requirement in a 1-in-10 stressed scenario and would be above 7% at the end of the forecast period.

Capital management continued

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

Capital resources

	31 December 2014		31 December 2013 (Restated)	
	Transitional	**Fully loaded**	Transitional	Fully loaded
Common Equity Tier 1 (CET1) capital: instruments and reserves				
Permanent share capital and the related share premium account	**1,759.5**	**1,759.5**	1,059.3	1,059.3
Retained earnings[2]	**(36.7)**	**(36.7)**	731.7	731.7
Available for sale and cash flow hedge reserves	**83.6**	**83.6**	(1.0)	(1.0)
Minority interests[4]	**6.1**	**10.6**	6.9	12.1
Independently reviewed interim profits net of any foreseeable charge or dividend	**–**	**–**	–	–
Other reserves[3]	**410.0**	**410.0**	410.0	410.0
CET1 capital before regulatory adjustments	**2,222.5**	**2,227.0**	2,206.9	2,212.1
CET1 capital: regulatory adjustments				
Prudential valuation in trading book	**(0.4)**	**(0.4)**	(2.1)	(2.1)
Intangible assets (net of related tax liability)	**(103.7)**	**(103.7)**	(110.7)	(110.7)
Deferred tax assets not arising from temporary differences	**–**	**–**	–	–
Cash flow hedge reserves	**(59.0)**	**(59.0)**	(13.1)	(13.1)
Expected loss shortfall	**(191.5)**	**(191.5)**	(238.3)	(238.3)
Securitisation positions treated as deduction	**–**	**–**	–	–
Losses for the year	**(236.4)**	**(236.4)**	(768.4)	(768.4)
Filter for unrealised gains on debt instruments held in the available for sale category	**–**	**–**	–	–
Unrealised gains or losses on available for sale assets (revaluation reserve)	**(24.6)**	**–**	–	–
Qualifying AT1 deductions that exceed AT1 capital	**–**	**–**	–	–
Total regulatory adjustments to CET1	**(615.6)**	**(591.0)**	(1,132.6)	(1,132.6)
CET1 capital	**1,606.9**	**1,636.0**	1,074.3	1,079.5
Additional Tier 1 (AT1) capital: instruments				
Perpetual non-cumulative preference shares	**–**	**–**	–	–
Minority interests[4]	**22.9**	**2.3**	21.7	2.4
AT1 capital before regulatory adjustments	**22.9**	**2.3**	21.7	2.4
AT1 capital: regulatory adjustments				
Intangible assets	**–**	**–**	–	–
Expected loss shortfall (half)	**–**	**–**	–	–
Total regulatory adjustments to AT1 capital	**–**	**–**	–	–
AT1 adjustments in excess of AT1 capital	**–**	**–**	–	–
AT1 capital	**22.9**	**2.3**	21.7	2.4
Tier 1 capital (T1 = CET1 + AT1)	**1,629.8**	**1,638.3**	1,096.0	1,081.9

Capital management continued

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

Capital resources continued

	31 December 2014		31 December 2013 (Restated)	
	Transitional	**Fully loaded**	Transitional	Fully loaded
Tier 2 (T2) capital: instruments and provisions				
Capital instruments	**196.4**	**196.4**	196.3	196.3
Minority Interests[4]	**0.8**	**3.0**	0.9	3.2
Credit risk adjustments[1]	**52.2**	**52.2**	63.9	63.9
T2 capital before regulatory adjustments	**249.4**	**251.6**	261.1	263.4
T2 capital: regulatory adjustments				
Revaluation reserves	**–**	**–**	–	–
Total regulatory adjustments to T2 capital	**–**	**–**	–	–
T2 capital	**249.4**	**251.6**	261.1	263.4
Total capital (TC = T1 + T2)	**1,879.2**	**1,889.9**	1,357.1	1,345.3

1. Following the full implementation of CRD IV reporting in 2014, the December 2013 capital resources have been reported in line with the Bank's 2014 CRD IV interpretation. The previously reported Tier 2 credit risk adjustment for 2013 has been revised to £63.9m. The fully loaded total capital ratio for 2013 has correspondingly been revised from 8.6% to 8.9%.
2. December 2013 retained earnings included in the regulatory capital position have been amended for the restatement of FSCS levy, changes to hedge accounting, and write off of certain assets. A reconciliation of statutory to regulatory loss for the year is included on page 136.
3. Other reserves includes the £410m capital redemption reserve created as a result of the Bank's Liability Management Exercise in 2013.
4. Minority interest represents the share of the capital and reserves of Unity Trust Bank that is attributable to third party investors. Under CRD IV the amount of minority interest which can be recognised by the Bank is allocated between the different tiers of capital.

Capital management continued

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

Capital ratios and Risk Weighted Assets

	31 December 2014		31 December 2013 (Restated)	
	Transitional	**Fully loaded**	Transitional	Fully loaded
Capital ratios				
Common Equity Tier 1 ratio	**12.7%**	**13.0%**	7.1%	7.2%
Tier 1 ratio	**12.9%**	**13.0%**	7.3%	7.2%
Total capital ratio	**14.9%**	**15.0%**	9.0%	8.9%
Risk Weighted Assets				
Credit risk	**11,500.4**	**11,500.4**	13,818.5	13,818.5
Market risk	**–**	**–**	–	–
Operational risk	**1,131.8**	**1,131.8**	1,255.2	1,255.2
Total Risk Weighted Assets	**12,632.2**	**12,632.2**	15,073.7	15,073.7
Segmental analysis of credit Risk Weighted Assets				
Core				
Retail	**1,866.6**	**1,866.6**	2,268.1	2,268.1
BaCB	**760.0**	**760.0**	990.3	990.3
Treasury/other	**1,723.8**	**1,723.8**	1,989.2	1,989.2
Total Core	**4,350.4**	**4,350.4**	5,247.6	5,247.6
Non-core				
Corporate CoAM	**3,624.0**	**3,624.0**	4,758.0	4,758.0
Optimum	**3,526.0**	**3,526.0**	3,661.6	3,661.6
Illius	**–**	**–**	151.3	151.3
Total Non-core	**7,150.0**	**7,150.0**	8,570.9	8,570.9
Total credit Risk Weighted Assets	**11,500.4**	**11,500.4**	13,818.5	13,818.5

Fully loaded CET1 ratio has increased to 13.0% from 7.2% as at 31 December 2013. This reflects an increase in CET1 of £556.5m and a decrease in Risk Weighted Assets of £2.4bn.

The increase in CET1 reflects:

- £700.2m increase in permanent share capital and related share premium accounts relating to the £313m injection from The Co-operative Group as part of the 2014 commitment and £387m capital raising (net of costs);
- £236.4m regulatory losses for the year; and
- £46.8m reduction in expected loss shortfall.

Credit risk RWAs have decreased in retail primarily due to the unsecured portfolios following a gradual decline in exposure across the year. The change in Corporate CoAM is driven by ongoing asset sales and deleveraging activity of the Non-core business. The Illius portfolio was sold in November 2014.

Operational risk RWAs have decreased by £123m following the annual recalculation of the Pillar I operational risk requirement following the 2013 year end results.

Capital management continued

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

Reconciliation of equity per balance sheet to total capital

Balance sheet presentation	Balance per accounts	Regulatory presentation	Regulatory Balance per accounts	Cash flow hedge reserve	Unrealised Gains on AFS Assets	Minority Interests	Deferred tax assets that are risk weighted	EL	Prudent valuation in trading book	Capital Resources Transitional Rules
Equity										
Ordinary share capital	**22.6**	Paid up capital instruments	**22.6**	**–**	**–**	**–**	**–**	**–**	**–**	**22.6**
Share premium account	**1,736.9**	Share premium	**1,736.9**	**–**	**–**	**–**	**–**	**–**	**–**	**1,736.9**
Retained earnings	**(273.1)**	Retained earnings	**(36.7)**	**–**	**–**	**–**	**–**	**–**	**–**	**(36.7)**
		Regulatory losses for the period	**(236.4)**	**–**	**–**	**–**	**–**	**–**	**–**	**(236.4)**
Available for sale reserve	**24.6**	Available for sale reserve	**24.6**	**–**	**(24.6)**	**–**	**–**	**–**	**–**	**–**
Cash flow hedging reserve	**59.0**	Cash flow hedging reserve	**59.0**	**(59.0)**	**–**	**–**	**–**	**–**	**–**	**–**
Capital redemption reserve	**410.0**	Other reserves	**410.0**	**–**	**–**	**–**	**–**	**–**	**–**	**410.0**
Non-controlling interests	**34.5**	Minority interest	**34.5**	**–**	**–**	**(4.7)**	**–**	**–**	**–**	**29.8**
Total equity	**2,014.5**		**2,014.5**	**(59.0)**	**(24.6)**	**(4.7)**	**–**	**–**	**–**	**1,926.2**
Non-Equity										
Other borrowed funds	**196.4**	Capital instruments	**196.4**	**–**	**–**	**–**	**–**	**–**	**–**	**196.4**
Intangible assets	**(103.7)**	Intangible assets (net of related tax liability)	**(103.7)**	**–**	**–**	**–**	**–**	**–**	**–**	**(103.7)**
Deferred tax assets	**21.0**	Deferred tax assets not arising from temporary differences	**21.0**	**–**	**–**	**–**	**(21.0)**	**–**	**–**	**–**
Impairment[1]	**683.2**	Expected loss shortfall	**683.2**	**–**	**–**	**–**	**–**	**(874.7)**	**–**	**(191.5)**
		Expected loss Tier 2 add-back	**–**	**–**	**–**	**–**	**–**	**52.2**	**–**	**52.2**
		Prudent valuation in trading book	**–**	**–**	**–**	**–**	**–**	**–**	**(0.4)**	**(0.4)**
Total non-equity	**796.9**		**796.9**	**–**	**–**	**–**	**(21.0)**	**(822.5)**	**(0.4)**	**(47.0)**
Total balances subject to own funds calculations	**2,811.4**	**Total balances subject to own funds calculations**	**2,811.4**	**(59.0)**	**(24.6)**	**(4.7)**	**(21.0)**	**(822.5)**	**(0.4)**	**1,879.2**

1. Impairment is included within loans and advances to customers within the statutory balance sheet.

Only impairment relating to exposures calculated under the IRB approach to credit risk are applicable for the calculation of Expected loss shortfall. Therefore the impairment number included in the table above relates to IRB exposures only, and is a subset of the Bank's total impairment.

Reconciliation of statutory to regulatory loss for the year

	31 December 2014	Restated 31 December 2013
Statutory loss for the period	**(225.2)**	(777.3)
Statutory loss attributable to minority shareholders	**(1.4)**	(0.9)
Discounted cash flows for ordinary shares not recognised until cash consideration paid	**(9.8)**	9.8
Regulatory loss for the period	**(236.4)**	(768.4)

Further details on restatements can be found in note 3.

Capital management continued

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

Fully loaded leverage ratio

	31 December 2014	Restated 31 December 2013
Accounting assets		
Derivative financial instruments	**(551.7)**	(538.6)
Derivative Cash collateral	**–**	–
Securities financing transactions (SFTs)	**–**	–
Loans and advances and other assets	**37,582.9**	43,383.8
Total accounting assets	**37,031.2**	42,845.2
Regulatory Consolidation Adjustments	**–**	–
Derivatives adjustments		
Potential future exposure on derivatives	**470.7**	517.7
Total derivatives adjustments	**470.7**	517.7
Counterparty risk leverage exposure measure for SFTs	**–**	–
Regulatory deductions and other adjustments[1]	**(354.6)**	(364.2)
Off-balance sheet items	**1,003.4**	1,738.2
Total fully loaded leverage exposure	**38,150.7**	44,736.0
Fully loaded CRD IV Tier 1 capital	**1,638.3**	1,081.9
Fully loaded leverage ratio	**4.3%**	2.4%

The fully loaded leverage ratio has increased to 4.3% as at 31 December 2014 (2013: 2.4% restated). The leverage ratio is calculated as Tier 1 capital divided by adjusted balance sheet exposures. The improvement in the ratio reflects a £556.4m increase in total Tier 1 capital and a £6.6bn decrease in regulatory leverage exposure reflecting the Bank's overall deleveraging strategy. The 31 December 2014 leverage ratio has been calculated using the Basel Committee January 2014 definition, with the 31 December 2013 leverage ratio remaining on a CRD IV basis. This is in line with guidance provided to the Bank by the PRA. The 2013 ratio has been restated for the prior year accounting restatements as detailed in note 3.

Along with CET1 ratio, the leverage ratio is expected to worsen during the plan period. It is expected to be sustainably above 3% towards the end of the plan period.

1. Includes an adjustment to reverse netting where accounting and regulatory rules differ.

Financial statements

Financial statements

Coming up:

This section of our Annual Report covers the financial statements. The Bank is defined as The Co-operative Bank plc and its subsidiary undertakings. The Company is defined as The Co-operative Bank plc. Most of the financial information relates to the Bank. We also have to show the balance sheet of our Company, which you will find right at the end of the section. The Bank financial statements shows all the companies under the control of the Bank added together and you will find these first.

This section includes the following key financial statements:

The pages following the key financial statements contain notes to the accounts, many of them required by accounting standards and legislation, which are designed to give you more information.

Look out for the blue highlights throughout these pages. We use them to explain the key statements and notes in plain English.

Independent auditor's report to the members of The Co-operative Bank plc only

Our opinion on the financial statements is unmodified

We have audited the financial statements of The Co-operative Bank plc (the Company) and its subsidiaries (together, the 'Bank') for the year ended 31 December 2014 set out on pages 148 to 279. In our opinion:

- the financial statements give a true and fair view of the state of the Bank's and of the Company's affairs as at 31 December 2014 and of the Bank's loss for the year then ended;
- the Bank's financial statements have been properly prepared in accordance with International Financial Reporting Standards as adopted by the European Union (IFRSs as adopted by the EU);
- the Company's financial statements have been properly prepared in accordance with IFRSs as adopted by the EU and as applied in accordance with the provisions of the Companies Act 2006; and
- these financial statements have been prepared in accordance with the requirements of the Companies Act 2006 and, as regards the Bank's financial statements, Article 4 of the IAS Regulation.

We emphasise one matter – Going Concern

In forming our opinion on the financial statements, which is unmodified, we have considered the adequacy of the disclosures made in part 1.3 of the Basis of preparation note of the financial statements on page 156 concerning the Bank's and Company's ability to continue as a Going Concern. In that section the Directors set out the risks associated with the successful execution of the Bank's 2015–2019 Strategic Plan (the Bank's Plan). These matters represent a material uncertainty which may cast significant doubt upon both entities' ability to continue as Going Concerns. These financial statements do not include the adjustments that would result if either the Bank or the Company were unable to continue as Going Concerns.

What have we audited?

We have audited the financial statements of the Company and the Bank for the year ended 31 December 2014, which comprise:

- the Bank income statement;
- the Bank statement of comprehensive income;
- the Bank balance sheet;
- the Bank statement of cash flows;
- the Bank statement of changes in equity;
- the Bank accounting policies and the related notes set out on pages 154 to 239;
- the Company balance sheet;
- the Company statement of cash flows;
- the Company statement of changes in equity; and
- the Company accounting policies and related notes set out on pages 246 to 279.

The financial reporting framework that has been applied in their preparation is applicable law and IFRSs as adopted by the EU and, as regards the parent company financial statements, as applied in accordance with the provisions of the Companies Act 2006.

This report is made solely to the 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.

Our work with respect to comparatives and opening balances

Given this was a first year audit we undertook additional work in relation to the comparative amounts and opening balances. As part of this we reviewed the work of the predecessor auditor in relation to their audit of the 2013 financial statements.

As well as obtaining input for our risk assessment and audit planning in relation to the 2014 audit, our work also considered whether the circumstances and evidence available could give rise to adjustments which would require retrospective restatement under IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors.

One of the outcomes of the review was the identification of areas where more work would have been required to complete an audit of the 2013 financial statements to the level of materiality that we had elected to use in relation to the audit of the 2014 financial statements. We then undertook additional procedures as we deemed necessary in those areas to obtain the requisite level of audit assurance. Examples of some of the more significant areas requiring additional work and consideration included the following:

- additional substantive procedures on the application of hedge accounting;
- further procedures in relation to the fair value adjustments that arise due to earlier transactions undertaken by the Bank;
- consideration of the unadjusted audit differences identified by the predecessor auditor;
- examination of tax balances and related accounting processes;
- substantiation of the journal entries within the Bank's Financial Statement Close Process FSCP; and
- consideration of the Bank's lack of retention of a documented full reconciliation between the Bank's sub and general ledgers for the 2013 Financial Year.

To further inform our audit risk assessment and planning we also considered the work and reports of various external reviews relating to the Bank during 2013 and 2014. These reviews included:

- The Conduct Committee of the Financial Reporting Council's (the FRC) review into the Bank's 2012 Annual Report and Accounts.
- An external review undertaken into the impairment charges that were recognised in June 2013 and whether those charges should have been recognised in the 2012 financial statements instead.
- An external review undertaken in May 2013 that incorporated an asset quality review on a sample of corporate connections; a review of Optimum segmentation to identify a range of plausible IAS 39 – Financial instruments: Recognition and Measurement provision calculations; a review of management's loan loss forecasts and the performance of fair value calculations under various scenarios for the Non-core portfolios.

Independent auditor's report to the members of The Co-operative Bank plc only continued

- An external review conducted in May 2013 into collateral values relating to corporate loans. The scope of this review was to consider the revaluations for collateral supporting key portions of the Corporate portfolio, being Commercial Real Estate (CRE) plus hotels and student accommodation.
- The Kelly Review – Failings in Management and Governance – An Independent Review of The Co-operative Bank.
- The review and commentary of the Treasury Select Committee into the Bank.

We used the views expressed in those reports and investigations to inform our risk assessment and also to assist with the identification of significant risks.

The 2013 comparatives as represented in the Annual Report and Accounts (the 'ARA') reflect the prior year adjustments discussed in Note 3 to the financial statements. These restatements were identified from the work highlighted above; from our work auditing the 2014 financial statements and from the Bank's work preparing the 2014 financial statements.

Our assessment of risks of material misstatement

The following risks had the greatest effect on our overall audit strategy; on the allocation of resources on the audit; and on directing the efforts of the engagement team:

- Going Concern
- The Bank's control environment
- Extent of manual finance processing
- Loan loss impairment
- Provisions for liabilities and charges related to conduct risk and related to the risk of non-compliance with the provisions of the Consumer Credit Act (CCA)
- Financial instrument fair values and hedge accounting
- Release of fair value adjustments.
- Income recognition from EIR accounting
- Separation from The Co-operative Group (TCG)

Taking these risks of material misstatement in turn:

Going Concern

Please refer to page 53 (Audit Committee report) and pages 156 to 158 (Basis of preparation note)

The risk: As described in the Basis of preparation note, the Going Concern status of the Bank is dependent on successful execution of the Bank's Plan. Successful execution of the Bank's Plan has risks and uncertainties associated with it which indicate the existence of a material uncertainty which may cast doubt on the ability of both the Bank and Company to continue as Going Concerns. The key risks inherent in the Bank's Plan include, inter alia:

- the ability of the Bank to implement and achieve the milestones and results set out therein, taking account of the stresses that could adversely affect the Bank's Plan such as achieving separation of business operations from TCG and the associated costs including subsequent pension funding arrangements;
- remediation of the Bank's IT systems and infrastructure which are outdated, poorly controlled and have a lack of proven end to end disaster recovery capabilities. In January 2015, the Bank entered into a major contract with a third party to remedy some of these key issues through outsourcing the Bank's enterprise computing services, and this project carries significant execution risk;
- the ability of the Bank to achieve the stress-based capital buffer required by the Prudential Regulation Authority (the PRA);
- the ability of TCG to meet its operational commitments to the Bank; and
- the ability of the Bank to avoid further regulatory action from either the PRA or from the Financial Conduct Authority (the 'FCA') including by continuing to deliver against its plan.

Our response: Our audit procedures have included, amongst others, understanding and questioning the assumptions and milestones in the Bank's Plan, such as those around remediation of the Bank's IT infrastructure, continued deleveraging of Non-core assets, reduction in the Bank's cost base and future return to profitability. This included assessing management's process for setting the Bank's Plan and then for monitoring progress against it.

Our challenge was undertaken with reference to our knowledge of the Bank and experience of the wider banking sector. We also gained an understanding of the key aspects of the financial and business planning process upon which the Bank's Going Concern assessment is based, assessing reasonableness of the design of the process, testing whether it incorporates appropriate and sufficient management reviews, and the consistency of the application of key assumptions.

We reviewed and objectively assessed management's estimates of the costs associated with the Bank's commitment to separate from TCG and obtained supporting evidence for management's estimates of those costs such as agreeing to third party contracts.

We tested the IT general controls within the Bank's IT infrastructure, which highlighted several control deficiencies including a lack of disaster recovery capability. This is an area in which both the PRA and FCA are holding the Bank to delivery of its remedial plan.

When assessing the ability of the Bank to achieve the stress-based capital buffer required by the PRA we considered market conditions and the Bank's plans around achieving further deleverage.

In considering the ability of TCG to honour its commitments to the Bank, we assessed the Directors' investigations and conclusions into the current position of TCG and its ability to fulfil its operational commitments.

We met with both the PRA and the FCA during the course of our work to understand the impact on our audit of their positions as regards the various areas which they are both holding the Bank to delivery of its remedial plans and refraining from taking further action against the Bank in this regard whilst those plans are being achieved, as referred to on page 26.

We also assessed whether the Bank's disclosures in relation to Going Concern adequately reflected the associated principal risks.

We concluded that the disclosures appropriately reflect the Directors' assessment of the Bank's position in relation to Going Concern, and we included an emphasis of matter in this Audit Report.

Independent auditor's report to the members of The Co-operative Bank plc only continued

The Bank's control environment

Please refer to pages 55 and 56 (Audit Committee report)

The risk: We identified weaknesses in the Bank's control environment in excess of what would be considered normal in the banking industry. This limited the opportunities we had to place audit reliance on the design, implementation and operating effectiveness of the key controls that management relies on as regards the proper functioning of the Bank's systems and processes. This is because the control environment currently involves an extensive use of manual controls such as end user computing rather than automated system-based controls. As mentioned elsewhere in the ARA, the Bank's deployment of an effective risk management framework is incomplete in key areas; there are weaknesses in the availability, quality and use of data from source systems for use in financial models; and there has been a loss of corporate knowledge following significant changes in personnel in key areas of the business.

As the robustness of financial reporting depends on the correct functioning of the operational and financial IT systems, as well as on the effectiveness of the Bank's wider control environment, the pervasive nature of this issue makes this a significant risk.

Our response: Our audit approach included an assessment of the quality and effectiveness of the internal controls that management relies on. We planned our audit to place reliance, where appropriate, on those internal controls including general IT controls where these could be determined as operating effectively. Where we were unable to place such reliance we addressed the increased pervasive risk by selecting audit procedures to obtain a greater proportion of evidence from substantive testing, for example, third party evidence, reconciliations between financial systems and increased sample sizes.

We used IT specialists within our audit team to conduct our IT procedures which included, amongst others, testing general IT controls relating to system access and change management, and testing controls over computer operations within specific applications which are required to operate effectively to mitigate the risk of misstatement within the financial statements.

For many IT systems, the controls were not operating effectively. We considered the impact of such ineffective operation on the Bank's financial information and, where relevant, extended the scope of our work by identifying and testing compensating manual controls or reduced our control reliance by undertaking additional substantive procedures.

Extent of manual finance processing

Refer to page 55 (Audit Committee report).

The risk: The Bank's FSCP, including the consolidation, is heavily reliant on manual processes and the extensive use of spreadsheets. Due to the multiplicity of ledgers involved, and the large number of journals posted manually, there is a risk that financial statement numbers and/or related disclosures may be misstated. This is therefore deemed a significant audit risk.

Our response: After assessing the design, implementation and operating effectiveness of the key controls over management's process for preparing and operating the FSCP we chose to adopt a primarily substantive approach with low testing thresholds for our audit. This included:

- reconciling the trial balances of the individual legal entities within the Bank back to the underlying primary ledgers;
- reviewing and investigating recurring journals related to prior periods by considering the nature of these journals to understand whether their posting is still required and that they are being posted for the correct amounts;
- reviewing and substantiating material intercompany adjustments; and
- testing that material manual adjustments have been reviewed and approved by management prior to posting as this is a key control that management relies on in connection with the accuracy of compilation of the financial statements. We then considered whether such journals have appropriate supporting evidence, were posted appropriately and are consistent with our conclusions on the judgements and estimates made by management.

We adopted a similar approach for the notes to the accounts by considering their preparation and testing that they agree to the Bank's underlying records and transactions.

Loan Loss Impairment

Refer to page 53 (Audit Committee report), pages 169 and 170 (Critical judgements and estimates note), Risk management section and pages 188 to 191 (financial disclosures).

The risk: The Bank continues to deleverage its lending portfolio by selling or securitising loans. As a result, there is a risk that the specific and collective loan loss provisions may not appropriately reflect the implications of this strategy in the forecasts of recoverable cash flows and in discounts to market values at the time of sale, including costs to sell.

As regards the retail lending portfolios, the concerns over the Bank's control environment noted above lead to an increased risk that inappropriate data such as inaccurate arrears flags, incorrect valuations from the use of invalid house pricing indices or mis-estimated forced sale discounts are being used in the Bank's collective provisioning models.

The portfolios giving rise to the greatest uncertainty are those which are subject to potential collateral shortfalls, in particular the Corporate and Optimum books. Optimum is a closed mortgage book of predominantly interest-only, intermediary sourced and acquired assets.

Given these factors, assessing the Bank's provisions for impairment losses is highly subjective, requires the Directors to exercise significant judgement, and incorporates the use of a number of assumptions. As a result, this is considered a significant audit risk.

Our response: We assessed the design, implementation and operating effectiveness of key controls over management's process for establishing and monitoring the levels of both specific and collective provisions. This included assessing the design of the recently introduced Strategic Asset Review and Strategic Asset Monitoring processes as well as reviewing and considering the Bank's governance and oversight over the Bank's various collective models. Our audit procedures included, amongst others, challenging the methodology behind the key valuation assumptions underlying the provisions, such as:

- emergence periods;
- probabilities of default;
- recovery rates;
- discount rates; and
- overlay adjustments used in the Bank's impairment models.

We considered these assumptions in the light of our knowledge of the Bank's portfolios, customer profiles, general market practice in the UK and based on the Bank's recent actual experience. This included reference to external collateral valuations which are generally obtained by the Bank for impaired corporate loans at least every 12 months.

Independent auditor's report to the members of The Co-operative Bank plc only continued

When undertaking our specific loan loss assessments, we considered the Directors' strategies for Non-core portfolios, including whether the assumptions as to recoverability were consistent with those stated strategies, including the expectation and timing of future cash flows arising from the realisation of security held for individually assessed loans. Our approach included the use of our own property valuation specialists to benchmark the key assumptions underpinning certain collateral valuations to their expectations which are based on their experience of the UK market.

We assessed the relevant credit risk data for completeness of capture and accuracy of extraction from the underlying Bank systems and also compared the inputs into the impairment models and tested the logic of the model calculations. This work was undertaken by our in-house model validation team.

We also assessed the adequacy of the Bank's disclosures in respect of its exposure to credit risk – please refer to Risk management section.

Provisions for liabilities and charges related to conduct risk and related to the risk of non-compliance with the provisions of the CCA

Please refer to page 53 (Audit Committee report), pages 171 and 172 (Critical judgements and estimates note) and pages 204 and 205 (financial disclosures)

The risk: The Bank carries a large number of provisions for various matters including those related to the conduct of the Bank towards its past and present customers such as:

- mis-selling PPI, interest rate swaps and packaged accounts;
- technical breaches of the CCA; and
- action detrimental to mortgage customers.

A risk exists that the Bank may not have appropriately identified all of the relevant areas of this exposure. The assessment of present obligations for customer redress requires significant judgement due to uncertainties over whether an obligation exists and the subjective assumptions used in the quantification of potential redress levels. In particular, the identification of compliance or conduct issues relating to mortgage customer detriment and packaged current accounts is highly judgemental, as is the identification of affected populations. In relation to the CCA, the impact of highly technical aspects of the Act can materially impact the Bank's ability to collect interest from customers. There is a heightened risk relating to the completeness of the data retained by the Bank, as well as with the complexity of modelling such provisions, as the issues being provided for generally have a number of inter-dependent variables that could all materially affect the outputs.

Due to the materiality of the potential redress for the items highlighted above this is considered a significant audit risk.

Our response: Our audit procedures have included, amongst others, considering how management establishes completeness of identified issues and the adequacy of provisions recognised. Our audit focused particularly on the Bank's processes for identifying possible customer redress issues and the integrity of data used to quantify obligations arising. Specifically, to assess the completeness of the issues being provided for and the populations of customers impacted by each issue, we:

- reviewed the external legal opinions obtained by the Bank as part of the Bank's process of deciding what matters create obligations for customer redress;
- obtained written representations from the Directors as regards completeness of issues provided for and as regards completeness of legal opinions seen;
- examined regulatory guidance and press releases to the market; and
- reviewed correspondence between the regulators and the Bank.

The Bank incorporated an allowance for data gaps and model risk in the above provisions. In relation to this, where applicable, we performed data completeness and accuracy checks on the Bank's models and tested the inherent logic. In addition, we performed two-way data testing between source systems and models. We assessed key assumptions including expected claims and uphold rates, redress levels and operating costs, and compared them to expectations based on the Bank's historical experience, current trends and our own industry knowledge. We also considered the sensitivity of the level of provisions to changes in these assumptions when scoping and performing our audit procedures.

We evaluated whether there was sufficient evidence to support management's assumptions. We also considered whether the Bank's disclosures in relation to customer redress provisions appropriately reflected the application of judgement by the Directors in estimating required provisions and in identifying potential contingent liabilities.

Financial instrument fair values and hedge accounting

Refer to page 54 (Audit Committee report), page 173 (Critical judgements and estimates note) and pages 195 and 196 (financial disclosures)

The risk: The Bank has a portfolio of derivative financial instruments which are used for hedging purposes, many of which are designated in hedge accounting relationships. Some derivative instruments are more complex in nature than others, and require the use of manual data inputs to valuation systems to calculate fair values at period ends. Based on our review of the 2013 ARA and the predecessor auditor's work papers, we identified a risk that these fair values may be susceptible to inaccurate data inputs, or inadequacies in the valuation methodologies being used.

The Bank applies hedge accounting at both micro and portfolio (macro) levels for both fair value and cash flow hedge accounting relationships. The application of hedge accounting under IAS 39 can be complex and requires that the Bank values hedged items for hedged risks only and then accurately identifies all sources of hedge accounting ineffectiveness that arise. Based on our review of the 2012 and 2013 ARAs, this was deemed an area of significant risk.

Our response: We assessed the design, implementation and operating effectiveness of the key controls over management's process for monitoring the Bank's treasury related activities. Our audit procedures included re-performance of valuations by our in-house derivative valuation experts for a sample of financial instruments which involved:

- assessing the valuation methodologies used by the Bank against our expectations of generally accepted valuation techniques;
- assessing the reasonableness of the assumptions used in the valuation models compared to our experience of market practices, which included assessing: sensitivity to intra-day FX volatility; the forward FX and swap curve inputs used in models; the curve building and interpolation logic being used; proxy rates used in place of market data for the valuation of certain instruments; and the discount factors being applied; and
- validation of the underlying trade data and model inputs for completeness and accuracy against original trade confirmations and market data as at period end.

Independent auditor's report to the members of The Co-operative Bank plc only continued

In order to assess the valuation risk, the portfolio was divided into instruments of lower and higher estimation uncertainty reflecting their fair value classification under IFRS 13 Fair Value Measurement. A greater extent of testing was performed on instruments assessed to have higher estimation uncertainty associated to their valuation.

In relation to hedge accounting, we assessed the hedge documentation, hedge relationship and the hedge designation for compliance with the requirements of IAS 39. We also considered management's oversight of the risks arising in this area. We then tested valuations of the hedged risks within hedged items on a sample basis, and considered whether the Bank had identified those sources of hedge accounting ineffectiveness that we would expect to be recorded based on our experience of sources of ineffectiveness observed in the market. We tested the Bank's calculations of hedge accounting effectiveness to assess whether the Bank had appropriately calculated hedge ineffectiveness to be recorded in the income statement and identified any hedge relationships that should be discontinued.

Finally, we considered the Bank's disclosures in relation to fair value accounting and hedge accounting to assess whether the requirements of IFRS as adopted by the EU were adequately reflected in the financial statements.

Release of fair value adjustments

Refer to page 54 (Audit Committee report), page 173 (Critical judgements and estimates note) and page 234 (financial disclosures)

The risk: At the time of the merger of The Co-operative Bank and Britannia Building Society in 2009, the Bank was required to make certain adjustments to the carrying value of acquired assets and liabilities in order to record them at their fair values. For financial assets and liabilities, these adjustments are generally released to the income statement over the behavioural lives of the assets and liabilities through their effective interest rate. A behavioural life is the estimated length of time for which a product such as a mortgage will be held by the Bank. For example, the behavioural life of a mortgage with a contractual term of 25 years is likely to be less as borrowers tend to move house or refinance their loan much earlier than the contractual expiry of the loan term.

Judgement is required about circumstances and conditions which indicate that the timing of the release of fair value adjustments to the income statement may need to be revised. This can arise when the assumed behavioural profiles need to be lengthened or shortened due to macro-economic or other circumstances. Due to the materiality of the fair value adjustments on the balance sheet and the need for significant judgement to be used when determining changes in behavioural lives of acquired assets and liabilities, this was identified as a significant risk.

Our response: Our audit procedures included, amongst others, comparing actual behaviours and redemption profiles of assets and liabilities to assumptions set at the date of acquisition or to revisions to these assumptions that were made subsequent to the date of acquisition. The Bank calculates the amount of fair value adjustments to be unwound in each period through various models. We tested the completeness and accuracy of data within these models through sample testing from model to source system and vice-versa.

We compared key characteristics of the acquired assets and liabilities which are still subject to fair value adjustments at the reporting date to those observed at the prior year end and to management's forecasts used to calculate the effective interest rate. Such key characteristics included prepayment trends and impairment losses. We used this comparison to form expectations of the amount to be recorded in the income statement and investigated variances between our expectations and reported movements. In addition, we tested models for clerical accuracy and consistency.

We challenged whether the models employed by the Bank appropriately reflected the performance of the various relevant portfolios from acquisition to the reporting date, as well as management's assumptions in relation to the future behaviours and characteristics of the relevant portfolios based upon our knowledge of the Bank's strategy to dispose of Non-core assets. Where incorporating changes in assumptions resulted in material changes to the forecast release periods we ensured that the Bank's models had been updated to reflect revised estimates of future behaviours. We also assessed the operating effectiveness of management's key review and oversight processes in this area.

We also considered the adequacy of the disclosures related to fair value adjustments within the financial statements.

Income recognition from EIR accounting

Refer to page 54 (Audit Committee report), page 173 (Critical judgements and estimates note)

The risk: The Bank operates a number of models to estimate its income under the Effective Interest Rate (EIR) accounting method. EIR spreads across the life of a financial instrument the costs incurred and fees received that are in substance an integral part of the overall yield. The EIR method also seeks to recognise interest at a constant rate across the expected life of a mortgage loan rather than at, for example, a lower rate in an initial fixed or discounted rate period and then a higher variable rate in the period that follows.

The method involves various calculations and judgements in both determining an instrument's initial EIR and recording the present value of adjustments arising under the method in subsequent periods when cash flows are reforecast. EIR models are most sensitive to changes in the estimates of the length of the behavioural lives of mortgages and future interest rate expectations. Modelled forecast cash flows may be inaccurate either due to the use of inaccurate data, inappropriate formulae or incorrect assumptions being used. Due to the complexity of calculation; the degree of judgement that needs to be exercised by management around forecast future cash flows; weaknesses in the Bank's data; and the number of different products the Bank has across its front and back books, this is considered a significant audit risk.

Our response: We assessed effectiveness of management's controls for setting and updating EIR assumptions and methodologies. Our audit procedures have included, amongst others, challenging management's assumptions used within the Bank's EIR accounting models. For example, we assessed the consistency of forecast standard variable rates with market derived base rate forecasts and the Bank's expectations of future interest margins, and we compared customer redemption assumptions with recent customer redemption behaviours observable in the Bank's portfolios. We considered the appropriateness of these assumptions in light of our knowledge of the Bank's portfolios, market conditions and observed practice in the UK mortgage sector.

Management utilises various models to calculate required EIR adjustments. The assumptions which are input into the models are derived from management's analysis of customer behaviours and forecast exogenous factors. We tested the completeness and accuracy of data within these models through sample testing from model to source systems and vice-versa. We tested the logic of the EIR model calculations through independent recalculation of EIR adjustments to assess the compliance of the Bank's modelling techniques with the requirements of IAS 39. We also used our in-house modelling experts to test the internal consistency and accuracy of the models employed by the Bank.

We also considered the completeness and accuracy of the disclosure of the sensitivities impacting EIR within the financial statements.

Independent auditor's report to the members of The Co-operative Bank plc only continued

Separation from TCG

Please refer to page 53 (Audit Committee report), page 173 (Critical judgements and estimates note) and page 205 (financial disclosures)

The risk: The completion of the Liability Management Exercise on 20 December 2013 significantly altered the Company's shareholding structure as did the May 2014 capital raise with TCG retaining a minority stake. As a result, the Bank committed to begin to implement steps to separate its operations from TCG over the short term. The Bank is currently reliant on TCG in a number of areas, the key example of which would be the provision of IT infrastructure until the Bank successfully transfers operation of its systems to its new outsource provider. Due to the complexity of such infrastructure, separation may result in additional expenses being incurred by the Bank or significant operational losses arising in the event that it is not executed in accordance with the current plan.

The Directors have also had to exercise significant judgement in assessing and measuring other impacts of such a separation, in particular, the identification of significant obligations (including pension obligations) arising from the separation process and the determination of whether such expenses should be capitalised, provided for up-front or expensed as they arise. This is considered a significant audit risk.

Our response: We considered the separation commitments entered into by the Bank and related documents, and evaluated the extent to which potential obligations exist in line with IAS 37 Provisions, Contingent Liabilities and Contingent Assets. We challenged the assumptions made and key judgements applied by management in the identification and measurement of obligations through obtaining evidence for the existence and completeness of commitments from contractual documents and the Bank's Plan, and other project plans, documentation and legal correspondence.

We assessed whether accounting for The Co-operative Group Pension Scheme (Pace) as a defined contribution plan and for the Britannia Scheme as a defined benefit plan in the current year was appropriate and in accordance with IAS 19 Employee benefits.

We assessed the adequacy of disclosures concerning additional liabilities that could arise when the impact on these pension arrangements of separation from TCG becomes clearer. We also assessed the adequacy of the Bank's disclosures in respect of the impact of its planned separation from TCG.

Our application of materiality

We apply the concept of materiality in both planning and performing the audit, and in evaluating the effect of misstatements on our audit and on the financial statements. For the purposes of determining whether the financial statements are free from material misstatement, we define materiality as the magnitude of misstatement that makes it probable that the economic decisions of a reasonably knowledgeable person, relying on the financial statements, would be changed or influenced.

When establishing our overall audit strategy, we determined a magnitude of uncorrected misstatements that we judged would be material for the financial statements as a whole. We determined materiality for the Bank to be £20m, which is 1% of total equity at the end of the year. The reason for selecting this measure as the basis for our materiality consideration is that the Bank's stated focus is to both maintain and restore capital and it is not expected to return to profitability in the short term. We also see this as the main focus for the users of the financial statements given the importance of regulatory capital to the Bank's solvency.

This level of materiality then provided the basis for:

- determining the nature, timing and extent of our risk assessment procedures;
- identifying and assessing the risk of material misstatement; and
- determining the nature, timings and extent of our audit procedures.

On the basis of our risk assessments, together with our assessment of the Bank's overall control environment, our judgement was that overall performance materiality (ie our tolerance for misstatement in an individual account or balance) for the Bank should be 50% of materiality, namely £10m.

Our objective in adopting this approach was to ensure that total uncorrected and undetected audit differences do not exceed our materiality for the financial statements as a whole.

As regards a reporting threshold, we agreed with the Audit Committee that we would report all adjusted and unadjusted audit differences in excess of £1m to them, 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 the light of other relevant qualitative considerations.

Respective responsibilities of the Directors and of ourselves as auditor

As explained more fully in the Directors' Responsibility Statement set out on page 66, the Directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

What does an audit of financial statements involve?

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of:

- whether the accounting policies are appropriate to the Bank and Company's circumstances and have been consistently applied and adequately disclosed;
- the reasonableness of significant accounting estimates made by the Directors; and
- the overall presentation of the financial statements.

In addition, we read all of the financial and non-financial information in the ARA to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Independent auditor's report to the members of The Co-operative Bank plc only continued

An overview of the scope of the audit

As highlighted, the materiality for the financial statements as a whole was set at £20m.

The Bank is principally managed from one location in Manchester, with certain functions such as treasury and some corporate activities operated in London. These functions and operations were subject to full scope audit procedures by the primary audit team, and comprise 98% of the Bank's operating income, 100% of the Bank's loss before taxation and 98% of the Bank's total assets.

Two legal entities that are consolidated by the Bank are managed separately. These entities are: Britannia International Limited, which is based in the Isle of Man and has prepared financial information on a break-up basis as at 31 December 2014; and Unity Trust Bank plc of which the Bank owns 26.7% and consolidates by virtue of controlling the majority of appointments to the Board. These two entities are not audited by Ernst & Young LLP, and account for 2% of the Bank's operating income; 2% of the Bank's total assets and were subject to specific scope audits. These audits covered net interest income, loss before taxation, loans and advances to customers and total assets.

The audits undertaken for Group reporting purposes at the non-EY components of the Bank were performed to a materiality level that we had set, being £1m. Detailed audit instructions were sent to the auditors of the two components. These instructions covered the significant audit areas that should be covered by these audits (which included the relevant risks of material misstatement detailed above) and set out the information required to be reported back to us. We then discussed the findings and conclusions with the non-EY component auditors as necessary.

Our opinion on other matters prescribed by the Companies Act 2006 is unmodified

In our opinion 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.

We have nothing to report in respect of the matters on which we are required to report by exception

Under the ISAs (UK and Ireland) we are required to report to you if, based on the knowledge we acquired during our audit, we have identified other information in the annual report that contains a material inconsistency with either that knowledge or the financial statements, a material misstatement of fact, or that is otherwise misleading.

In particular, we are required to report to you if:

- we have identified material inconsistencies between the knowledge we acquired during our audit and the Directors' statement that they consider the ARA taken as a whole is fair, balanced and understandable and provides the information necessary for shareholders to assess the Bank's performance, business model and strategy; or
- the Corporate Governance Section of the ARA describing the work of the Audit Committee does not appropriately address matters communicated by us to the Audit Committee.

Under the Companies Act 2006 we are required to report to you if, in our opinion:

- adequate accounting records have not been kept by the Company, or returns adequate for our audit have not been received from branches not visited by us; or
- the 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.

In addition to our audit of the financial statements, the Directors have engaged us to review their Corporate Governance statement and Directors' statement in relation to Going Concern as if the Company were required to comply with the Listing Rules. Under the terms of our engagement we are required to review:

- the Directors' statement, set out on page 38, in relation to Going Concern; and
- the part of the Corporate Governance statement on page 41 relating to the Company's compliance with the nine provisions of the 2012 UK Corporate Governance Code specified for our review.

We have nothing to report in respect of the above responsibilities.

Peter Wallace (Senior Statutory Auditor)
for and on behalf of Ernst & Young LLP, Statutory Auditor
London
26 March 2015

Notes:
1. The maintenance and integrity of The Co-operative Bank plc website 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 website.
2. Legislation in the UK governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

The Bank financial statements

The Bank income statement

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

In plain English:

The Bank income statement shows most of the income earned and expenses incurred during the year for all the companies in the Bank. Other items are shown in the statement of comprehensive income on the next page.

The numbers in brackets are costs or losses. The earnings per share is simply the net profit or loss divided by the weighted average number of shares.

	Notes	2014	Restated 2013
Interest receivable and similar income	7	**1,051.8**	1,245.6
Interest expense and similar charges	7	**(706.8)**	(930.7)
Net interest income		**345.0**	314.9
Fee and commission income	8	**197.3**	219.9
Fee and commission expense	8	**(74.9)**	(72.1)
Net fee and commission income		**122.4**	147.8
Net trading (expense)/income	9	**(2.9)**	3.8
Other operating income	10	**2.4**	30.6
Operating income		**466.9**	497.1
Operating expenses			
Operating expenses	11	**(852.6)**	(847.3)
Provision for customer redress	33	**(52.3)**	(307.0)
Intangible asset impairment	22	**–**	(148.4)
Total operating expenses		**(904.9)**	(1,302.7)
Operating loss before impairment losses		**(438.0)**	(805.6)
Impairment gains/(losses) on loans and advance	18	**173.2**	(516.2)
Operating loss pre Liability Management Exercise		**(264.8)**	(1,321.8)
Profit from Liability Management Exercise	39	**–**	688.3
Operating loss post Liability Management Exercise		**(264.8)**	(633.5)
Share of post-tax profits from joint ventures	37	**0.6**	0.7
Loss before taxation		**(264.2)**	(632.8)
Income tax	13	**39.0**	(144.5)
Loss for the financial year		**(225.2)**	(777.3)
Attributable to:			
Equity shareholders	14	**(226.6)**	(778.2)
Non-controlling interests		**1.4**	0.9
		(225.2)	(777.3)
Loss per share (basic and fully diluted)	14	**(61.48)p**	(211.12)p

In 2013, £194.5m was disclosed separately on the face of the income statement as a deduction from interest receivable and similar income for conduct redress on certain loans. Similarly in 2013, £185.1m was disclosed separately on the face of the income statement as a deduction from fees and commission income.

As the Bank is not legally entitled to interest income and similar income in respect of customers affected by certain breaches of the technical requirements of the Consumer Credit Act (CCA), £104.5m of interest income collected in 2013 has been excluded from interest receivable and similar income and the line item has been re-presented. The remaining deductions of £90.0m of interest income and £185.1m of fee and commission income have been re-presented as charges within provisions for customer redress, which is what these amounts related to in 2013.

In total £101.2m (2013: £411.5m) of conduct and legal provisions have been recognised during 2014. Further details are disclosed in note 33.

EPS for 2013 has been re-presented as described in note 14.

Comparative figures have been restated as described in note 3.

The notes on pages 154 to 239 form part of these financial statements.

The Bank statement of comprehensive income

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

In plain English:

As well as the net profit or loss reported in the income statement, there are a number of other items not reported in the income statement which are instead shown here. These items are typically unrealised gains and losses arising from revaluing certain financial assets and hedging instruments. This statement starts with the profit or loss we reported in the income statement and then adds/deducts these other amounts to show the overall result (ie the total comprehensive income).

	Equity shareholders 2014	**Non-controlling interests 2014**	**Total 2014**	Equity shareholders 2013	Restated Non-controlling interests 2013	Restated Total 2013
(Loss)/profit for the financial year	**(226.6)**	**1.4**	**(225.2)**	(778.2)	0.9	(777.3)
Other comprehensive (expense)/income that may be recycled to profit and loss:						
Changes in cash flow hedges						
Net changes in fair value recognised directly in equity	**43.1**	**(0.1)**	**43.0**	(39.9)	(0.7)	(40.6)
Income tax	**(6.4)**	**–**	**(6.4)**	9.3	0.2	9.5
Transfers from equity to income or expense	**11.5**	**–**	**11.5**	(13.7)	–	(13.7)
Income tax	**(2.3)**	**–**	**(2.3)**	3.2	–	3.2
Changes in available for sale assets						
Net changes in fair value recognised directly in equity	**63.8**	**–**	**63.8**	(32.7)	–	(32.7)
Income tax	**(15.7)**	**–**	**(15.7)**	7.6	–	7.6
Transfers from equity to income or expense	**(12.5)**	**(0.3)**	**(12.8)**	(24.8)	–	(24.8)
Income tax	**3.1**	**0.1**	**3.2**	5.6	–	5.6
Revaluation of equity shares	**–**	**–**	**–**	0.1	–	0.1
Income tax	**–**	**–**	**–**	0.1	–	0.1
Other comprehensive income/(expense) for the financial year, net of income tax	**84.6**	**(0.3)**	**84.3**	(85.2)	(0.5)	(85.7)
Total comprehensive (expense)/income for the financial year	**(142.0)**	**1.1**	**(140.9)**	(863.4)	0.4	(863.0)

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

The notes on pages 154 to 239 form part of these financial statements.

The Bank balance sheet

At 31 December 2014

All amounts are stated in £m unless otherwise indicated

In plain English:

The Bank balance sheet is a financial snapshot at the end of each year, showing the financial position. It shows all the assets owned by the Bank and how those assets have been funded (liabilities and the equity – the shareholders' investment in the Bank).

You will find more information about the various lines in the Bank balance sheet in the notes to the financial statements.

	Notes	2014	Restated 2013	Restated 2012
Assets				
Cash and balances at central banks	16	**4,765.3**	5,418.8	5,433.0
Loans and advances to banks	17	**1,608.4**	1,594.4	1,904.1
Loans and advances to customers	18a	**25,377.4**	30,286.1	33,327.1
Fair value adjustments for hedged risk	18b	**148.5**	106.3	354.2
Investment securities – loans and receivables	19a	**18.1**	23.6	295.0
Investment securities – available for sale	19b	**3,167.5**	2,732.4	3,789.4
Investment securities – fair value through income or expense	19c	**1,236.9**	1,743.4	1,845.2
Investment securities – held for trading	19d	**–**	–	960.2
Derivative financial instruments	20	**470.7**	555.8	818.8
Non-current assets classified as held for sale	15	**387.3**	–	–
Equity shares	21	**2.8**	5.8	5.7
Investments in joint ventures	37	**5.3**	4.7	3.9
Investment properties	23	**2.1**	164.1	173.0
Property, plant and equipment	24	**67.5**	115.2	113.4
Intangible assets	22	**103.7**	110.7	263.2
Amounts owed by other Co-operative Group undertakings		**–**	–	56.8
Other assets	25	**187.6**	480.9	70.3
Prepayments and accrued income	26	**12.2**	16.5	14.9
Current tax assets		**0.6**	–	172.6
Deferred tax assets	34	**21.0**	25.1	162.5
Total assets		**37,582.9**	43,383.8	49,763.3
Liabilities				
Deposits by banks	27	**615.4**	2,757.5	3,612.0
Customer accounts		**29,614.0**	32,463.3	35,884.4
Customer accounts – capital bonds	28	**263.8**	538.1	888.1
Debt securities in issue	29	**3,443.6**	4,207.6	4,716.2
Derivative financial instruments	20	**551.7**	538.6	967.6
Other borrowed funds	30	**196.4**	196.3	1,258.6
Amounts owed to other Co-operative Group undertakings	38	**–**	–	190.0
Other liabilities	31	**157.8**	202.9	104.0
Accruals and deferred income	32	**16.0**	54.1	20.1
Liabilities directly associated with non-current assets classified as held for sale	15	**7.9**	–	–
Provisions for liabilities and charges	33	**617.5**	549.7	137.9
Current tax liabilities		**0.3**	4.2	–
Deferred tax liabilities	34	**84.0**	103.0	121.4
Total liabilities		**35,568.4**	41,615.3	47,900.3
Capital and reserves attributable to the Bank's equity holders				
Ordinary share capital	39	**22.6**	12.5	410.0
Share premium account	39	**1,736.9**	1,359.8	8.8
Retained earnings		**(273.1)**	(46.4)	1,326.6
Available for sale reserve		**24.6**	(14.1)	30.0
Capital redemption reserve	39	**410.0**	410.0	–
Cash flow hedging reserve		**59.0**	13.1	54.2
		1,980.0	1,734.9	1,829.6
Non-controlling interests		**34.5**	33.6	33.4
Total equity		**2,014.5**	1,768.5	1,863.0
Total liabilities and equity		**37,582.9**	43,383.8	49,763.3

The 2013 and 2012 comparatives have been restated as described in note 3.

Approved by the Board on 26 March 2015

Dennis Holt, Chairman
Niall Booker, Chief Executive

The notes on pages 154 to 239 form part of these financial statements.

The Bank statement of cash flows

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

In plain English:

The Bank statement of cash flows shows how we generate cash from our banking business (cash from operational activities), how we have spent cash (investing activities) and how we have borrowed or spent cash to fund our business or pay for our funding (financing activities) for all the companies in our Bank.

As well as showing the overall amount of cash generated or spent in the year, we also show how this movement has affected our cash and cash equivalents (ie the short term deposits that can be converted to cash quickly).

	2014	Restated 2013
Cash flows used in operating activities		
Loss before taxation	**(264.2)**	(632.8)
Adjustments for:		
Decrease in prepayments and accrued income	**4.3**	4.7
(Decrease)/increase in accruals and deferred income	**(38.1)**	13.4
Interest payable in respect of other borrowed funds	**22.8**	96.0
Effect of exchange rate movements	**0.5**	(0.6)
Fair value movement on investment properties	**4.5**	8.0
Impairment (gains)/losses on loans and advances	**(170.9)**	517.3
Movements on investment impairments	**(20.0)**	(18.5)
Depreciation and amortisation	**40.0**	33.9
Impairment of intangible assets	**7.6**	142.0
Interest amortisation	**6.0**	(4.2)
Fair value movements and amortisation of investment securities	**(206.2)**	142.1
Impairment of property, plant and equipment	**14.7**	21.2
(Gain)/loss on disposal of property, plant, equipment and software	**(0.2)**	0.5
Non-cash effect of LME transaction	**–**	(688.3)
Loss on disposal of investment property	**1.2**	–
Unwind of fair value adjustments arising on transfer of engagements	**97.5**	52.1
Preference dividend	**–**	5.4
	(500.5)	(307.8)
Decrease in deposits by banks	**(2,142.1)**	(854.5)
Decrease in customer accounts and capital bonds	**(3,123.6)**	(3,863.2)
Decrease in debt securities in issue	**(764.0)**	(603.0)
Decrease in loans and advances to banks	**105.3**	54.5
Decrease in loans and advances to customers	**5,073.6**	2,941.8
Decrease in amounts owed by other Co-operative Group undertakings	**–**	(47.6)
Increase in amounts owed to other Co-operative Group undertakings	**–**	58.8
Net movement of other assets and other liabilities	**(236.2)**	95.8
Income tax received	**4.3**	45.0
Net cash flows used in operating activities	**(1,583.2)**	(2,480.2)
Cash flows from investing activities		
Purchase of tangible and intangible fixed assets	**(74.9)**	(55.7)
Proceeds from sale of property, plant and equipment	**8.3**	1.7
Proceeds from sale of investment property	**156.5**	1.3
Purchase of investment securities	**(2,279.0)**	(4,425.3)
Proceeds from sale and maturity of investment securities	**2,580.0**	6,681.2
Net cash flows from investing activities	**390.9**	2,203.2
Cash flows from financing activities		
Interest paid on other borrowed funds	**(22.8)**	(83.9)
Dividends paid to non-controlling interests	**(0.2)**	(0.2)
Preference share dividends paid	**–**	(5.9)
Capital Commitment received from The Co-operative Group	**313.0**	–
Costs incurred relating to the May 2014 Capital Raising	**(12.8)**	–
Cash proceeds relating to the May 2014 Capital Raising	**400.0**	145.0
Net cash flows from financing activities	**677.2**	55.0

The Bank statement of cash flows continued

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

	2014	Restated 2013
Decrease in cash and cash equivalents	**(515.1)**	(222.0)
Cash and cash equivalents at the beginning of the financial year	**6,092.2**	6,314.2
Cash and cash equivalents at the end of the financial year	**5,577.1**	6,092.2
Cash and balances with central banks (note 16)	**4,707.5**	5,352.6
Held for sale (note 15)	**9.1**	–
Loans and advances to banks (note 17)	**745.5**	634.6
Short term investments (note 19)	**115.0**	105.0
	5,577.1	6,092.2

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

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

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

The notes on pages 154 to 239 form part of these financial statements.

The Bank statement of changes in equity

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

In plain English:

The changes in equity statement shows how the various lines in the equity section of the Bank balance sheet (on page 150) have moved during the year. The main change is the loss for the year and issuance of the new share capital.

	Attributable to equity holders of the Bank								
	Share capital	Share premium	Available for sale reserve	Cash flow hedging reserve	Capital redemption reserve	Retained earnings	Total	Non-controlling interest	Total equity
2014									
Balance at the beginning of the year (as restated)	**12.5**	**1,359.8**	**(14.1)**	**13.1**	**410.0**	**(46.4)**	**1,734.9**	**33.6**	**1,768.5**
Total comprehensive (expense)/income for the year	**–**	**–**	**38.7**	**45.9**	**–**	**(226.6)**	**(142.0)**	**1.1**	**(140.9)**
Transactions with owners recorded directly in equity:									
Issuance of new share capital	**10.1**	**377.1**	**–**	**–**	**–**	**–**	**387.2**	**–**	**387.2**
Dividend	**–**	**–**	**–**	**–**	**–**	**(0.1)**	**(0.1)**	**(0.2)**	**(0.3)**
Balance at the end of the year	**22.6**	**1,736.9**	**24.6**	**59.0**	**410.0**	**(273.1)**	**1,980.0**	**34.5**	**2,014.5**
2013									
Balance at the beginning of the year (as restated)	410.0	8.8	30.0	54.2	–	1,326.6	1,829.6	33.4	1,863.0
Total comprehensive (expense)/income for the year	–	–	(44.1)	(41.1)	–	(778.2)	(863.4)	0.4	(863.0)
Cancellation of share capital	(410.0)	–	–	–	410.0	–	–	–	–
Issuance of new share capital	12.5	777.5	–	–	–	–	790.0	–	790.0
Transfer of retained earnings to share premium	–	594.8	–	–	–	(594.8)	–	–	–
Transaction costs	–	(21.3)	–	–	–	–	(21.3)	–	(21.3)
Dividend	–	–	–	–	–	–	–	(0.2)	(0.2)
Balance at the end of the year (as restated)	12.5	1,359.8	(14.1)	13.1	410.0	(46.4)	1,734.9	33.6	1,768.5

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

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

The notes on pages 154 to 239 form part of these financial statements.

Notes to the Bank financial statements

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

Coming up:

The next four notes provide details of the basis of preparation and accounting policies applied in producing these financial statements and the critical judgements therein. In addition, details are provided explaining a prior period restatement and the impact of the Liability Management Exercise completed during the year.

1. Basis of preparation and significant accounting policies

1.1 Basis of preparation

Both the Company financial statements and the Bank financial statements have been prepared and approved by the Directors in accordance with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB), and as adopted by the European Union (EU).

On including the parent company financial statements within the Bank's Annual Report and Accounts, the 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 approved financial statements.

The financial statements have been prepared under the historic cost convention as modified by the revaluation of available for sale financial assets, derivative contracts, investment properties and certain other financial assets and financial liabilities held at fair value. The Bank applies the recognition, measurement and disclosure requirements of IFRS in issue that are endorsed by the EU and are effective for accounting periods beginning on or after 1 January 2014.

The financial statements comprise all audited sections of the accounts. Where indicated, the risk management section on pages 85 to 130 and capital management section on pages 131 to 137 form part of the audited accounts.

Standards and interpretations issued and effective

In preparing this consolidated financial information, the Bank has adopted the following pronouncements during the year that are new or revised:

- IFRIC 21 (Levies (2013))
  This interpretation gives guidance on the recognition of a liability to pay a levy that is accounted for in accordance with IAS 37 Provisions, Contingent Liabilities and Contingent Assets. A levy is an outflow of resources embodying economic benefits that is imposed by governments on entities in accordance with legislation other than outflows of resources covered by other standards, fines or other penalties that are imposed for breaches of the regulation. The obligating event that gives rise to a liability to pay a levy is the activity that triggers the payment of the levy, as identified by the legislation. The Bank adopted this interpretation from 1 January 2014, when recognising the Financial Services Compensation Scheme (FSCS) Levy. The impact of the application has been to increase brought forward reserves at 1 January 2013 by £24.8m as the FSCS Levy will be recognised annually on 1 April, rather than the date upon which the Bank's share of the levy is calculated as a proportion of the total market protected deposit, being 31 December.
- IFRS 10 (Consolidated Financial Statements (2011))
  This new standard introduces a single consolidation model for all entities based on control, irrespective of the nature of the investee. It supersedes both IAS 27 (Consolidated and Separate Financial Statements (2008)) except where IAS 27 still applies as noted below, and Amended SIC 12 (Consolidation: Special Purpose Entities (2004)). It aims to provide transparency in identifying off-balance sheet, parent subsidiary relationships, using a consistent basis for determining the existence and thus consolidation of those underlying entities being controlled by the reporting entity. The amendment to IFRS 10 has not had a material impact on the 2014 financial statements of the Bank.
- IFRS 11 (Joint Arrangements (2011))
  This new standard establishes principles for financial reporting by parties to a joint arrangement. It supersedes both IAS 31 (Interests in Joint Ventures (2010)) and Amended SIC 13 (Jointly Controlled Entities: Non-Monetary Contributions by Venturers (2007)). Recognition criteria now distinguish between joint operations and joint ventures on their relative 'rights and obligations' scope. A joint operation interest is accounted for between assets, liabilities, revenue and expense, whilst a joint venture is restricted to equity accounting. The amendment to IFRS 11 has not had a material impact on the financial statements of the Bank.
- IFRS 12 (Disclosure of Interests in Other Entities (2011))
  This new standard applies to entities that have an interest in a subsidiary, a joint arrangement, an associate or an unconsolidated structured entity. It aims to provide disclosure transparency on the reporting entity's risks associated with its interests in other entities, in conjunction with IFRS 10's application which determines the existence of such entities. A number of unconsolidated securitisation holding companies have been identified where the Bank is considered the sponsor of such entities. Disclosure has been made in note 2 in relation to such entities.
- Amended IAS 27 (Consolidated and Separate Financial Statements (2011))
  This amendment occurs as a direct consequence of IFRS 10's issuance, which now acts as the new single authority on consolidation requirements. IAS 27's scope has therefore reduced and focuses more specifically on separate financial information accounting bases. Under IAS 27, an entity shall therefore prepare its separate financial information using one of two bases; either at cost or in accordance with IFRS 9 (or IAS 39 if an entity has not yet adopted IFRS 9). The amendment to IAS 27 has no material impact on the financial statements of the Bank.

Notes to the Bank financial statements continued

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

1. Basis of preparation and significant accounting policies continued

- Amended IAS 28 (Investments in Associates and Joint Ventures (2011))
  This amendment occurs as a direct consequence of IFRS 10's issuance, which now acts as the new single authority on consolidation requirements. IAS 27's scope has therefore reduced and focuses more specifically on separate financial information accounting bases. Under IAS 28, an entity shall therefore prepare its separate financial information using one of two bases; either at cost or in accordance with IFRS 9 (or IAS 39 if an entity has not yet adopted IFRS 9). The amendment to IAS 28 has no material impact on the financial statements of the Bank.
- Amendments to IAS 32 (Offsetting Financial Assets and Financial Liabilities)
  The current offsetting model in IAS 32 requires an entity to offset a financial asset and financial liability only when the entity currently has a legally enforceable right of set-off and intends either to settle on a net basis or to realise the asset and settle the liability simultaneously. This amendment clarifies the position when offsetting financial assets and financial liabilities. The legal right of set-off must be available today and legally enforceable for all counterparties in the normal course of business, as well as in the event of default, insolvency or bankruptcy. The amended disclosures requires more extensive disclosures than are currently required. The disclosures focus on quantitative information about recognised financial instruments that are offset in the balance sheet, as well as those recognised financial instruments that are subject to master netting or similar arrangements irrespective of whether they are offset. The amendment to IAS 32 has no material impact on the financial statements of the Bank.
- Amendment to IAS 36 (Recoverable Amount Disclosures for Non-financial Assets (2013))
  This amendment changes the disclosure requirements of IAS 36 when the recoverable amount is based on fair value less costs of disposal. The amendment removes the requirement to disclose the recoverable amount when a cash generating unit (CGU) contains goodwill or indefinite life intangible assets where there has been no impairment. In addition, the amendment requires additional information about the fair value measurement when the recoverable amount of impaired assets is based on fair value less cost of disposal. The new amendment requires detailed disclosure of how the fair value less costs of disposal has been measured when an impairment loss has been recognised or reversed. The amendment to IAS 36 has no material impact on the financial statements of the Bank.
- Amendment to IAS 39 (Novation of derivatives and continuation of hedge accounting (2013))
  This amendment allows hedge accounting to continue where a derivative, which has been designated as a hedging instrument, is novated to effect clearing with a central counterparty as a result of laws or regulation, if specific conditions are met. The amendment to IAS 39 has no material impact on the financial statements of the Bank.

Standards and interpretations issued but not yet effective

At the date of authorisation of these financial statements, the Bank has not applied 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.

- IFRS 9 (Financial Instruments (2014))
  This new standard was issued in July 2014 and supersedes IAS 39 Financial Instruments: Recognition and Measurement. The standard includes requirements for recognition and measurement, impairment, de-recognition and general hedge accounting. The standard also supersedes IFRS 9 (2009), IFRS 9 (2010) and IFRS 9 (2013).

  Due to the short period of time which has elapsed since the issue of the standard, the Bank has not yet estimated the financial effects, although it is expected that IFRS 9 will have a significant impact for the Bank, in line with the wider industry. The standard is mandatory for years beginning on or after 1 January 2018 but is available for early adoption subject to EU endorsement.
- Amendments to IFRS 10 (Consolidated financial statements) and IAS 28 (Investments in associates and joint ventures (2014))
  These amendments address an inconsistency between the requirements in IFRS 10 and those in IAS 28 in dealing with the sale or contribution of assets between an investor and its associate or joint venture. The main consequence of the amendments is that a full gain or loss is recognised when a transaction involves a business (whether it is housed in a subsidiary or not). A partial gain or loss is recognised when a transaction involves assets that do not constitute a business, even if these assets are housed in a subsidiary.

  The amendments are mandatory for years beginning on or after 1 January 2016 but are available for early adoption subject to EU endorsement. The impact to the Bank of the amendments is likely to be immaterial.
- Amendment to IFRS 11 (Joint arrangements: on acquisition of an interest in a joint operation (2014))
  This amendment adds new guidance on how to account for the acquisition of an interest in a joint operation that constitutes a business. The amendments specify the appropriate accounting treatment for such acquisitions.

  The amendment is mandatory for years beginning on or after 1 January 2016 but is available for early adoption subject to EU endorsement. The impact to the Bank of the amendment is likely to be immaterial.
- IFRS 15 (Revenue from Contracts with Customers (2014))
  This standard was issued in May 2014 and is a converged standard from the IASB and FASB on revenue recognition. IFRS 15 specifies how and when an IFRS reporter will recognise revenue as well as requiring such entities to provide users of financial statements with more informative, relevant disclosures. This standard supercedes IAS 18 (Revenue) and a number of revenue related Interpretations.

  The standard will be effective for annual reporting years beginning on or after 1 January 2017 subject to EU endorsement. The impact to the Bank of the amendments is likely to be immaterial as income from IAS 39 financial instruments is outside the scope of IFRS 15, however, the Bank has not yet finalised its estimation of the financial effects.

Notes to the Bank financial statements continued

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

1. Basis of preparation and significant accounting policies continued

- Amendment to IAS 16 (Property, plant and equipment) and IAS 38 (Intangible assets: on depreciation and amortisation (2014))
  In this amendment the IASB has clarified that the use of revenue based methods to calculate the depreciation of an asset is not appropriate because revenue generated by an activity that includes the use of an asset generally reflects factors other than the consumption of the economic benefits embodied in the asset. The IASB has also clarified that revenue is generally presumed to be an inappropriate basis for measuring the consumption of the economic benefits embodied in an intangible asset.

  The standard is mandatory for years beginning on or after 1 January 2016 but is available for early adoption subject to EU endorsement. The impact to the Bank of the amendments is likely to be immaterial.

- Amendments to IAS 27 (Separate financial statements: on the equity method (2014))
  These amendments allow entities to use the equity method to account for investments in subsidiaries, joint ventures and associates in their separate financial statements.

  The standard is mandatory for years beginning on or after 1 January 2016 but is available for early adoption subject to EU endorsement. The impact to the Bank of the amendments is likely to be immaterial.

- Amendments to IAS 1 (Presentation of Financial Statements)
  The narrow-focus amendments to IAS 1 Presentation of Financial Statements clarify, rather than significantly change, existing IAS 1 requirements. In most cases the proposed amendments respond to overly prescriptive interpretations of the wording in IAS 1. The impact to the Bank of the amendments is likely to be immaterial.

Other standards and interpretations have been issued but these are not considered to be relevant to the Bank's operations.

The Bank intends complying with standards from the date they become effective.

1.2 Financial Reporting Council

The following disclosures were made in the 2013 Annual Report and Accounts as a result of enquiries by the Conduct Committee of the Financial Reporting Council.

- The PRA's assessment of the Bank's capital requirements which were disclosed in the Bank's 4 November 2013 prospectus. Due to the specific circumstances of the Bank similar updated disclosures were included in the 2013 Annual Report and Accounts.
- Clarification of the nature of the acquisition fair value adjustment made in respect of loans acquired in the merger with the Britannia Building Society.
- Comparative fair value disclosures for loans and advances at 31 December 2012 using the revised valuation methodologies applied at 31 December 2013.
- Recognition of the investment in the new core IT banking system as an intangible asset of the Bank as at 31 December 2012 by way of a prior period adjustment and disclosure of the rationale for this change in treatment.

The disclosures have been presented in the 2014 Annual Report and Accounts where relevant.

1.3 Going Concern

a) Introduction

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

The assessment of the appropriateness of using the Going Concern basis of accounting has been subject to a thorough process involving analysis and discussion by management, Executive and Board Committees and the Board, in line with our governance processes, and discussion with the PRA and FCA. This analysis included a particular focus on the 12 month period ending 31 March 2016.

Following the capital shortfall identified in 2013, and the subsequent successful capital raising exercises, the Bank is now in the early stages of its turnaround.

The completion of the capital raising exercises removed elements of uncertainty around the Going Concern status of the Bank. However, whilst important steps, these are not in themselves sufficient to recapitalise the Bank in the long term. There continue to be material uncertainties around the Bank's ability to continue as a Going Concern which relate to the implementation of the plan as discussed in (e) below. In particular, the Bank needs ongoing regulatory acceptance of the Bank's position until the IT platform is remediated and the Bank has rebuilt its capital strength to be able to withstand a significant stress. See page 26 for more information.

The 2015–2019 plan was reviewed and accepted by the PRA following the Stress Test Results (Stress Test) announced on 16 December 2014. This plan has been designed to enable the Bank to withstand a stress of the severity of the Stress Test by the end of the plan period and involves reshaping and restructuring the business as a core relationship bank.

Notes to the Bank financial statements continued

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

1. Basis of preparation and significant accounting policies continued

b) The plan

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

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

The revised plan, accepted by the PRA, accelerates the reduction in RWAs via expediting deleverage of the Optimum portfolio.

c) Capital

Following receipt of the final component of the £313m Capital Contribution on 31 December 2014, the Bank met the Individual Capital Guidance (ICG) for total capital set by the PRA at the end of the year, however it is not forecast to sustainably remain compliant for most of the duration of the 2015–2019 planning period. The PRA has reviewed and accepted the 2015-2019 plan as revised following the Bank of England Stress Testing announcements[1].

Total CRD IV capital resources as at 31 December 2014 are £1.9bn (31 December 2013 £1.3bn) with Core Tier 1 capital after regulatory deductions of £1.6bn (31 December 2013 restated £1.1bn). The Bank's CET1 ratio stands at 13.0% (31 December 2013 restated 7.2%) on a CRD IV end point basis.

d) Liquidity

Since 31 December 2013, the liquid asset ratio has increased to 17.4% as at 31 December 2014 (31 December 2013 restated: 16.1%). This liquid asset ratio increase is due to a reduction in total assets, despite a decrease in primary liquidity. The Bank continues to maintain a liquidity position above regulatory minima and in excess of its internal risk appetite.

During the period to 31 December 2014, the Bank has actively managed a reduction in customer deposits with a reduction in customer assets. Within the aggregate customer deposit reduction in the period to 31 December 2014, Core Retail customer deposits decreased by £2.2bn. The Bank has also repaid bilateral facilities and repo funding during the course of the year, and optionally redeemed the Silk Road Finance Number Two securitisation in September 2014 of £500m.

e) Risks and uncertainties

Key risks associated with successful execution of the plan include:

1. On 20 December 2013, the Bank began the process of separating its operations from its former parent, the Co-operative Banking Group Limited, and its ultimate former parent, The Co-operative Group, with both of which it shares premises, systems and services. The work is complex and time consuming and despite forecasting that separation costs will be higher than originally envisaged, there remains a risk that the costs of executing these separation plans may increase. The potential misalignment of Group and Bank's objectives may also make separation slower and more costly than anticipated;
2. The Bank participates in The Co-operative Group's defined benefit pension scheme (Pace). As long as the Bank remains a participating employer in Pace, the Bank could be 'last man standing' in the event of the failure of one or more of the other participating employers meaning that some or all of Pace's liabilities would need to be borne by the Bank. In addition, a material difference to current estimates of the funding of the pension scheme, or the Bank being forced to pay for a greater proportion than currently envisaged, could cause the Bank to require further capital in addition to that referred to above;
3. The Bank's IT system has been underinvested for a considerable period of time. The Bank needs to urgently and significantly improve and re-engineer its existing IT platform as the existing infrastructure is unsuitable and inherently fragile. There are also concerns about its resilience as the Bank's IT disaster recovery plan is not proven end to end. The Bank has entered into, in January 2015, an Enterprise Services (ES) contract with IBM in order to address this risk, however until that work is completed the Bank is at risk of an IT failure causing material disruption to Bank's products and services. The required improvement and re-engineering of the Bank's IT platform and operational process is necessary and significant in scale, complexity and cost; in common with any programme of this scale it carries a significant level of execution risk. Any delays in, or failure by, the Bank to deliver the re-engineering of the Bank's IT platform may result in ongoing risk of technology failure, significant additional investment costs, subject the Bank to further regulatory scrutiny or sanction and impact the Bank's ability to deliver its strategy. The Bank's regulators are fully aware of the steps the Bank is taking to address these operational risks[1];
4. More generally, the ability of the Bank to achieve the results set out in the 2015-2019 plan. In this respect particular challenges include (but are not limited to): ability to achieve the targeted cost savings; ability to retain customers and deposits; the timing and quantum of impacts to capital from the asset reduction exercise; meeting its planned improvements in net interest margin; the ability of the Bank to generate sufficient Core Bank asset growth; a possible further deterioration in the quality of the Bank's asset portfolio; unplanned costs from (for example) conduct risk matters, regulatory investigations, IT investment and the ability to maintain the Bank's access at an appropriate cost to liquidity and funding;
5. The ability of the Bank to raise additional non-CET1 capital assumed in the plan; and
6. To move forwards with its plan, the Bank requires the regulators' ongoing acceptance of its inability to meet regulatory requirements and expectations, including ICG. To the extent this is not forthcoming or to the extent that the Bank does not perform in line with its Business plan or regulatory capital requirements are increased for any reason, additional CET1 capital may be required over and above that included in that plan in order for the Bank to remain a Going Concern, and the PRA or FCA could exercise their powers under the Banking Act of 2009[1].

1 More information on the regulatory position of the Bank can be found on page 26.

Notes to the Bank financial statements continued

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

1. Basis of preparation and significant accounting policies continued

f) Conclusion

The Directors have concluded that, despite lower than expected losses and higher CET1 for the year ended 31 December 2014, the risks set out above, and their consequential effects, represent a material uncertainty which may cast significant doubt upon the Bank's ability to continue as a Going Concern. The Bank may, therefore, be unable to continue realising its assets and discharging its liabilities in the normal course of business. Nevertheless, after making enquiries and considering the current forecasts, in particular those for the period up to and including 31 March 2016, the Directors have a reasonable expectation that the Bank will have adequate resources to continue in business over this period. For these reasons, they continue to adopt the Going Concern basis in preparing these financial statements. This set of financial statements does not include the adjustments that would result if the Bank was unable to continue as a Going Concern.

1.4. Significant accounting policies

The accounting policies set out below have been applied consistently to all periods, inclusive of assets recognised where the Bank is subject to the substantial risks and rewards of those assets.

1. Business combinations

On 1 August 2009, The Co-operative Bank plc merged with Britannia Building Society, with Britannia transferring their engagements to the Bank. This business combination has been accounted for applying the requirements of IFRS 3 (Business Combinations (2004)).

The consideration transferred was valued by reference to the members' interests acquired. Financial assets and liabilities which, following the Bank's accounting policies, would be carried at amortised cost, were brought onto the balance sheet at their fair value at acquisition and were subsequently carried at amortised cost using the effective interest rate method. The income statement includes the results of the engagements transferred from Britannia since the date of acquisition.

2. Basis of consolidation

a) Subsidiaries

Subsidiaries are entities controlled by the Company. Control exists whenever the Company is exposed to, or has rights to, variable return from its involvement in an entity and has the ability to affect those returns through its power over the entity. 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 uniform accounting policies and is based on the same accounting period as the Company.

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; for the Bank this includes:

- various securitisation transactions in which mortgages were sold to SPEs. The equity of these SPEs is not owned by the Company; and
- Covered Bond Limited Liability Partnerships created in order to act as a guarantor for the issue of covered bonds.

An SPE is consolidated if, based on an evaluation of the substance of its relationship with the Bank and the SPE's risks and rewards, the Company concludes that it controls the SPE.

The following circumstances may indicate a relationship in which, in substance, the Company controls and consequently consolidates an SPE:

- the activities of the SPE are being conducted on behalf of the Company according to its specific business needs so that the Bank obtains benefits from the SPE's operation;
- the Company has the decision making powers to obtain the majority of the benefits of the activities of the SPE;
- the 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 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 above circumstances apply to all Company SPEs. Consequently the Company consolidates each SPE.

The assessment of whether the Company has control over an SPE is carried out at inception. No further assessment of control is carried out unless changes in the structure or terms of the SPE or additional transactions between the Bank and the SPE occur.

Notes to the Bank financial statements continued

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

1. Basis of preparation and significant accounting policies continued

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.

Those parties are called joint venturers. The Bank's interests in joint ventures are accounted for using the equity method. The consolidated financial information includes the Bank's share of the income and expenses and equity movements of equity accounted investees, after adjustments to align the accounting policies with those of the Bank.

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. The Bank does not consolidate structured entities where the Bank does not control the structured entity. The Bank acts as a sponsor for certain unconsolidated securitisation vehicle holding companies which the Bank neither owns nor controls. The Bank has determined itself a sponsor of unconsolidated securitisation vehicle holding companies if the Bank does not have a material ongoing interest in the entity, but it may act to protect its reputation in relation to the structured entity. No income has been received from unconsolidated structured entities during the year (2013: £nil). The carrying value of all assets transferred to unconsolidated structured entities during the year is £nil (2013: £nil).

3. Revenue recognition

a) Interest income and expense

Interest income and expense is recognised on an EIR basis, inclusive of directly attributable incremental transaction costs and fees including arrangement and broker fees, valuation and solicitor costs, discounts and premiums where appropriate.

The 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 Bank 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.

For assets acquired at a value significantly below the carrying value in the acquiree's financial information because they have incurred loss, expectations of future loss are higher than at origination, and interest spreads have widened because of deteriorating market conditions, the calculation of EIR is the same as shown above with the exception that the estimates of future cash flows include credit losses.

Early redemption charges are recognised on a cash basis as received.

b) Fees and commissions

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 effective interest 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, not included in the effective interest calculation, is recognised on an accruals basis as the service is provided.

Fees and commissions payable to introducers 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.

4. Financial instruments (excluding derivatives)

a) Recognition

The Bank initially recognises loans and advances 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 Bank commits to purchase or sell the asset. All other financial assets and liabilities are initially recognised on the trade date at which the Bank becomes a party to the contractual provisions of the instrument.

Notes to the Bank financial statements continued

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

1. Basis of preparation and significant accounting policies continued

b) Derecognition

The Bank 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 or in which the Bank neither transfers nor retains substantially all of the risks and rewards of ownership and it does not retain control of the financial asset.

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), and any cumulative gain or loss that had been recognised in other comprehensive income, is recognised in the income statement.

When available for sale financial assets are derecognised, the cumulative gain or loss, including that previously recognised in reserves, 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.

c) Financial assets

i. Overview

The Bank classifies its financial assets (excluding derivatives) as either:

- 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 the Bank does not intend 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 effective interest rate method. The amortised cost is the amount advanced less principal repayments, plus or minus 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 Bank has elected to carry the loans and advances to customers at fair value through income or expense as described in accounting policy (4.c) iv. below) and assets reclassified from available for sale (see below).

The Bank has a number of facility agreements with multiple counterparties, which form a single contractual relationship. The Bank considers these arrangements to be single financial instruments and accounts for these accordingly within loans and advances to customers or customer deposits respectively.

iii. Available for sale

Available for sale financial assets are debt securities and equity shares that are not held for trading and are intended to be held for an indefinite period of time. 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. In exceptional circumstances, for instance where the market in the securities has become inactive, the Bank has reclassified such assets as loans and receivables.

Any transfer back from loans and receivables, upon reclassification, would be measured at fair value based on current bid prices where quoted in an active market. Where there is no active market or the debt securities or 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.

Notes to the Bank financial statements continued

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

1. Basis of preparation and significant accounting policies continued

iv. Financial assets at fair value through profit or loss

These are:

- Financial assets designated 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 and recognition inconsistency or where management specifically manages an asset or liability on that basis, eg capital bonds.

  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 trading income as they arise.
- Financial assets held for trading
  Financial assets held for trading are assets which have been principally acquired for the purpose of selling or repurchasing in the near term, or they form part of a portfolio of identified financial instruments that are managed together for which there is evidence of a recent pattern of short term profit taking. These financial assets are recognised on the date of trade, when the Bank enters into contractual arrangements with counterparties to purchase or sell financial instruments, and are normally derecognised when sold. Measurement is initially at fair value, with transaction costs taken to the income statement. Subsequently their fair values are remeasured, and gains and losses from changes therein are recognised in the income statement within trading income.

d) Financial liabilities

i. Overview

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 and capital bonds, are subsequently measured at amortised cost.

Capital bonds within customer accounts have been designated at fair value through profit or loss upon initial recognition in the balance sheet. Changes in fair value are recognised through the income statement.

The capital bonds are economically hedged using equity linked derivatives, which do not meet the requirements for hedge accounting. Recording changes in fair value of both the derivatives and the related liabilities through the income statement most closely reflects the economic reality of the transactions. In doing so this accounting treatment eliminates a measurement inconsistency that would otherwise arise from valuing the capital bonds at amortised cost and the derivatives at fair value.

ii. Other borrowed funds

Borrowings are recognised initially at fair value, which equates to issue proceeds net of transaction costs incurred. Borrowings are subsequently stated at amortised cost; any difference between proceeds net of transaction costs and the redemption value is recognised in the income statement over the period of the borrowings using the EIR method.

The Bank classifies capital instruments as financial liabilities or equity instruments in accordance with the substance of the contractual terms of the instruments. The Bank's preference shares were classified as financial liabilities as they carried the right to a fixed non-cumulative preferential dividend and were subsequently presented in other borrowed funds. The dividends on these preference shares were recognised in the income statement as interest expense on an amortised cost basis using the EIR method.

As part of the LME on 20 December 2013, all the preference shares were transferred to The Co-operative Group (via the Banking Group). The Co-operative Group waived its rights to income and capital under the preference shares. Accordingly, the preference shares have been extinguished as financial liabilities in the 2013 balance sheet even though they have not been redeemed.

iii. Perpetual subordinated bonds

Perpetual subordinated bonds were carried at their nominal value plus any premium and a fair value adjustment for hedged risk where items were designated as part of a fair value hedge relationship. Interest payable on perpetual subordinated bonds was recognised in the income statement using the EIR method.

The perpetual subordinated bonds were cancelled and, therefore, extinguished as financial liabilities on 20 December 2013 as part of the LME.

Notes to the Bank financial statements continued
For the year ended 31 December 2014
All amounts are stated in £m unless otherwise indicated

1. Basis of preparation and significant accounting policies continued

5. Impairment provisions

a) Assessment

i. Objective evidence

At the balance sheet date, the Bank assesses those financial assets, not held at fair value through profit and loss, for objective evidence of an impairment loss.

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 by the Bank to the borrower, for economic and legal reasons relating to the borrower's financial difficulty, a concession that the Bank would not otherwise consider, indications that a borrower or issuer will enter bankruptcy or other financial reorganisation, or the disappearance of an active market for a security.

The Bank considers evidence for impairment for loans and advances at both a specific asset and collective level.

ii. Forbearance

The Bank operates a policy of forbearance which mitigates against borrower default. All such cases are included within its provisioning methodology.

- Residential secured mortgages
  Loans under forbearance are subject to a specific identified impairment assessment.
- Unsecured retail business
  Irrespective of forbearance, impairment is charged in accordance with the identified past due and unidentified loss event approaches described on page 102.
- Corporate business
  All accounts subject to forbearance which are in default and on the watchlist are individually assessed for impairment.

For further information on the Bank's approach to forbearance, its management and execution, see the risk management section on page 104.

b) 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 on watchlist, or in default, are individually assessed for impairment.

Loans and advances that do not meet the criteria for individual impairment are collectively assessed for impairment (incurred but not yet reported) by grouping together loans and advances of similar risk characteristics.

ii. Collective accounts

a) Retail

When assessing collective impairment for secured retail loans, the Bank estimates incurred losses on mortgages based on the borrower's external credit score or where the loan is specifically identified as being subject to forbearance.

When assessing collective impairment for unsecured retail loans, the Bank estimates losses on loans with delinquency greater than a pre-determined trigger point. In addition, the Bank makes provision on all loans arising from fraud and loans transferred to debt collection agencies. In respect of unsecured loans, the Bank uses statistical modelling of historical trends of probability of default, timing of recoveries and the amount of loss incurred.

The model's results are adjusted for management's judgement as to whether current economic and credit conditions are such that actual losses are likely to differ from those suggested by historical modelling. Once impaired, accounts are subjected to higher levels of impairment according to both their relevant stage of delinquency, ie 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.

Notes to the Bank financial statements continued

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

1. Basis of preparation and significant accounting policies continued

b) Corporate

All loans other than those to which a specific provision has been applied are included in the Corporate collective calculation. The collective provision applied is to multiply the drawn balance of the loan by an estimated propensity for the loan to default (PD) during a loss emergence period by the estimated Loss Given Default (LGD). A 100% propensity to default is applied for all commercial real estate loans where the indexed loan-to-value (LTV) is greater than 100% and to those loans which are due to contractually expire in the next 12 months and the indexed LTV is greater than 65%. All other PDs are based on recently observed loan migration experience or regulatory PDs where these are deemed to be more appropriate. Loans which are on watchlist will therefore have a higher PD than those cases in the live book.

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 or variable 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 income or expense.

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 fair value of an impaired available for sale equity security is recognised directly in equity.

6. Offsetting

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.

7. 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 repledge 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 using the EIR method.

Securities purchased under agreements to re-sell (reverse repos) are classified as loans and advances to banks on the balance sheet, as appropriate.

Notes to the Bank financial statements continued

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

1. Basis of preparation and significant accounting policies continued

8. 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, futures, options and combinations of these instruments. The Bank also uses equity derivatives to hedge the equity risks within its capital bonds.

Derivative financial instruments are stated at fair value based on quoted market prices in active markets and, where these are not available, using valuation techniques such as discounted cash flow models. Further information is provided in note 40. 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 Bank formally documents the relationship between the hedging instrument(s) and hedged item(s) including the risk management objective and strategy in undertaking the hedge transaction together with the method used to assess effectiveness of the hedging relationship.

The Bank makes an 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' on 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 results of 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 income or expense 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 its risk management process the Bank identifies portfolios whose interest rate risk it wishes to hedge. The portfolios may comprise only assets, only liabilities or both assets and liabilities. The Bank analyses each portfolio 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 Bank decides the amount it wishes to hedge and designates as the hedged item an amount of assets or liabilities from each portfolio equal to this.

The Bank measures monthly the change in fair value of the portfolio relating to the risk that is being hedged. Provided that the hedge has been highly effective, the Bank recognises the change in fair value of each hedged item 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 average useful life of the hedge item.

The Bank measures the fair value of each hedging instrument 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.

Notes to the Bank financial statements continued

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

1. Basis of preparation and significant accounting policies continued

b) Embedded derivatives

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 income or expense), 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.

c) Derivatives used for trading purposes

Derivatives entered into for trading purposes include swaps, forward rate agreements, futures, options and combinations of these instruments. Derivatives used for trading purposes are measured at fair value and any gains or losses are included in the income statement. The use of derivatives and their sale to customers as risk management products as appropriate, is an integral part of the Bank's trading activities.

9. Financial guarantee contracts

Financial guarantees, in respect of intra-group funding and the pension deficit in respect of the Britannia Pension Scheme, are treated as insurance contracts in accordance with IFRS 4 (Insurance Contracts (2004)). In accordance with the standard, the recognised insurance liability is assessed based on the current estimate of forecast future cash flows. If this highlights that the liability is inadequate, the liability is increased and the corresponding charge taken through the income statement.

10. Property, plant and equipment

The Bank recognises assets where it is exposed substantially to all the risks and rewards of those assets.

Acquired computer software licences are capitalised on the basis of cost incurred to acquire and bring the software to use.

Items of property, plant and equipment are stated at cost less any accumulated depreciation and impairment losses. Depreciation is provided on a straight line basis at the following rates, which are estimated to write down the assets to realisable values at the end of their useful lives.

Freehold and long leasehold land and buildings	40–50 years
Freehold and leasehold improvements	10–40 years
Short leasehold buildings	life of lease
Equipment:	
Computer	3–7 years
Furniture and equipment	3–10 years

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 less than the recoverable amount, an impairment charge 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 with the carrying amount of property, plant and equipment, and are recognised net within operating expenses in the income statement.

Notes to the Bank financial statements continued

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

1. Basis of preparation and significant accounting policies continued

11. Intangible assets

The Bank recognises intangible assets where it is exposed substantially to all the risks and rewards of those assets.

a) Computer software

Computer software is stated at cost less cumulative amortisation and impairment and comprises computer software together with the costs of development of the software.

Acquired computer software licences are capitalised on the basis of cost incurred to acquire and bring the software to use.

Costs that are directly associated with the internal production of software products that will generate future economic benefit are capitalised. Only costs which meet the definition of development costs under IAS 38 (Intangible Assets) are capitalised, with costs being capitalised only if the asset can be reliably measured, will generate future economic benefits and there is an ability to use the asset. Expenditure that is not directly attributable to the development of such assets is recognised in the income statement in the period to which it relates.

The expenditure capitalised includes direct employee costs and an appropriate portion of relevant direct overheads. Amortisation is charged to the income statement on a straight line basis to allocate the cost over the estimated useful life up to a maximum of seven years.

b) Other intangible assets

Other intangible assets are stated at cost less cumulative amortisation and impairment. Amortisation is charged on a straight line basis over the useful life of the asset. For core systems, a review of the asset's useful life is carried out and a maximum useful life of up to ten years is applied.

c) Impairment

Intangible assets are assessed for indications of impairment at least annually. 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 less than the greater of the value in use and the fair value less costs to sell, an impairment charge is recognised to this value in the income statement. Irrespective of whether there is any indication of impairment, intangible assets in the course of construction are tested for impairment at least annually.

12. Goodwill

All business combinations are accounted for by applying the purchase method. Goodwill represents amounts arising on acquisition of subsidiaries, associates and joint ventures and represents the difference between the cost of the acquisition and the fair value of the identifiable assets, liabilities and contingent liabilities acquired.

If a business combination is achieved without transfer of consideration, the amount of goodwill is calculated by reference to the fair value of the Bank's interest in the acquiree using a valuation technique. The technique involves assessing the future net cash flow of the acquiree and then discounting using a rate that reflects current market assessment of the time value of money and risks specific to the acquiree.

Goodwill is stated at cost less any accumulated impairment losses. Goodwill is not amortised but is tested for impairment on an annual basis. Where impairment is required, the amount is recognised in the income statement and cannot be subsequently reversed.

13. Leases

a) Overview

The Bank enters into leases for land and buildings and operating leases for 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 Bank's policy is to provide for the minimum future lease payments on buildings that it does not currently use, net of expected rental income from sub-leases. The Bank provides 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.

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.

Notes to the Bank financial statements continued
For the year ended 31 December 2014
All amounts are stated in £m unless otherwise indicated

1. Basis of preparation and significant accounting policies continued

c) Assets leased from third parties

i. Finance leases

Finance lease assets are initially recorded at the lower of fair value and the present value of the minimum lease payments, and subsequently in accordance with the relevant policy for the underlying asset. An equal liability is recorded in other liabilities. Interest 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.

14. Investment property

Property held for long term rental yields that is not occupied by the Bank, or property held for capital appreciation, is classified as investment property. Investment property comprises freehold land and buildings. It is carried at fair value. Fair value is based on current prices in an active market for similar properties in the same location and condition. No depreciation is provided on these properties. Any gain or loss arising from a change in fair value is recognised in the income statement.

If the Bank takes occupancy of an investment property, it is reclassified as property, plant and equipment and its fair value at the date of reclassification becomes its cost for subsequent accounting purposes. Similarly, transfers to the investment property portfolio are made when occupancy by the Bank ceases and the property meets the criteria of an investment property under IAS 40. Prior to such a transfer the property is measured at fair value with any gain or loss recognised in the income statement.

15. 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.

Overdrafts that are repayable on demand and form an integral part of the Bank's cash management are included as a component of cash and cash equivalents for the purpose of the cash flow statement.

16. 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 addition, estimated amounts receivable from tCG for tax losses surrendered and changes in that estimate are recorded as an adjustment to the tax expense.

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 Board's approved revised 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.

Notes to the Bank financial statements continued
For the year ended 31 December 2014
All amounts are stated in £m unless otherwise indicated

1. Basis of preparation and significant accounting policies continued

17. Pension costs

a) Co-operative Pension Scheme

The Bank participates in The Co-operative Pension Scheme (Pace). Pace is a hybrid scheme, consisting of a defined benefit section and a defined contribution section. There is currently insufficient information available to consistently and reliably identify the Bank's share of its liabilities in respect of this multi-employer scheme. For this reason the pension costs in respect of Pace are accounted for on a defined contribution basis in accordance with IAS 19 Employee Benefits (revised 2011). Pension costs are recognised as an expense in the Bank's income statement. See note 35 for further details.

b) Britannia Pension Scheme

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

Following the separation of the Bank from the wider Co-operative Group, the Britannia scheme is now accounted for on a defined benefit basis within the accounts of the Bank. See note 35 for further details.

Accordingly, the Bank recognises the fair value of the scheme assets less the present value of the scheme's estimated obligations, discounted at a high quality corporate bond rate, less an asset restriction that reflects the Bank's inability to access the surplus in the scheme.

18. Foreign currency

The functional and presentational currency for the Bank 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 ruling at that date. Foreign currency differences arising on translation are recognised in the income statement, except for foreign currency differences arising on translation of 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 values are translated to sterling at the exchange rates prevailing at the dates the values were determined.

19. Investments in Bank undertakings

Investments in subsidiaries are initially measured at fair value which equates to cost and subsequently valued at cost less impairment.

20. Provisions for liabilities and charges

A provision is recognised in the balance sheet if the Bank has 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 a pre-tax rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability.

In the case of restructuring provisions, a constructive obligation arises when a plan is sufficiently detailed and is formalised. Restructuring provisions include only direct expenditure arising from the restructuring plan which is both necessary and for restructuring and not associated with the Bank's ongoing activities.

Provisions are recognised for discounts on performing loans identified for disposal at the balance sheet date which will be sold post year end at a loss.

21. 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.

22. 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 remeasurement 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 remeasured in accordance with applicable IFRSs before the fair value less costs to sell of the disposal group is determined.

Notes to the Bank financial statements continued

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

2. Critical judgements and estimates

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

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

The judgements and assumptions that are considered to be the most important to the portrayal of the Bank's financial condition are those relating to loan impairment provisions, conduct risk and legal provisions, deferred tax, pensions, hedge accounting, separation, effective interest rates (EIR) and interest recognition relating to breaches of technical requirements of the Consumer Credit Act.

a. Loan impairment provisions

i. Overview

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

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

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

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

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

ii. Collective provisions

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

a) Core

i) Unsecured and secured residential

The Bank's collective provision for unsecured and secured retail personal advances is £108.3m (2013: £164.7m). Loans are identified as impaired by taking account of the stage of the debt's delinquency, the product type and the regularity of payments made whilst in arrears. The provision is calculated using assumed probabilities of default (PD) and a loss given default (LGD) for unidentified impairment.

The provision rates reflect the likelihood that the debt will be written off or charged off at some point in the future. The PD and LGD parameters are based on historical experience and are subject to regular review.

A key estimate within the unsecured models is the probability that impaired accounts move to a default status during the outcome period. The model uses historical actual data over a defined period of time to arrive at an average probability of accounts moving to default. If the maximum PD had been used for each category of arrears and for each product, this would increase the collective provision by £5.8m for all of the unsecured portfolios.

A key estimate of the secured impairment model provisioning is forced sales discount. The forced sales discount is an average and is calculated using historical actual data over a defined outcome period. If the maximum forced sales discount for the outcome period was used to calculate the provision across the secured portfolios excluding Optimum it would increase by £6.8m.

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

b) Non-core

i) Corporate

The Bank's collective provision against corporate loans in the Non-core division has decreased to £16.7m (2013: £40.0m).

The collective provision is calculated using factors such as observed default rates and LGD. As assessment is made of the likelihood of the loan becoming recognised as impaired in the loss emergence period and for loans that are impaired the likelihood of them moving to default over the outcome period. The calculation of the collective provision relies heavily on assumed probabilities of default.

Notes to the Bank financial statements continued

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

2. Critical judgements and estimates continued

There were no significant changes to the collective provision methodology in 2014 except for i) utilising property collateral for non-CRE customers when assessing their loss rates, and ii) the introduction of explicit discounting in assessing the proceeds of property sales.

The strategic deleveraging of the Bank's Non-core assets in 2014 has been the primary reason for the reduction in the collective provision.

The impact of increasing the default rates by 10% is an increase of the collective by £2.1m. The impact of increasing other parameters that affect the loss rate by 10% is not significant.

ii) Optimum collective

In addition to the above, collective provisions of £12.4m (2013: £9.4m) are held in the Optimum segment of the Non-core business.

A key estimate is the collateral value. A 10% decrease to the indexed collateral value used in the model would increase the provision by £22.1m.

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

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

iii) Individual provisions

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

a) Core

i) Unsecured and secured residential

Individual provisions for unsecured and secured residential lending total £4.5m (2013: £10.7m). There were no significant changes made to the provision methodology in 2014.

Sensitivities to the key estimates within the secured residential individual impairment model are disclosed in the risk management section.

b) Non-core

i) Corporate

The Bank's individual impairment provision on Corporate loans totals £386.8m (2013: £698.4m). The provision has decreased reflecting improving macroeconomic factors and the Bank's strategic deleverage of Non-core assets.

The determination of individual impairment provisions requires the exercise of considerable management judgement involving matters such as economic conditions and the resulting trading performance of the customer and the value of security held, for which there may not be a readily accessible market. In particular, significant judgement is required by management in assessing the borrower's cash flows and debt servicing capability together with the realisable value of collateral. The actual amount of the future cash flows and their timing may differ from the assumptions made for the purposes of determining the impairment provision and consequently these provisions can be subject to change over time. A key estimate within the provision is collateral valuation. A 10% decrease in collateral values would increase the provision by £47.3m.

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

ii) Optimum individual

The Bank's individual impairment provision on Optimum mortgages is £9.5m (2013: £26.1m). Mortgage accounts are identified as impaired and provided for on an individual basis by taking account of the stage of the debt's delinquency.

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

Notes to the Bank financial statements continued

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

2. Critical judgements and estimates continued

b. Conduct risk and legal provisions

i. Overview

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

Significant components of the conduct risk and legal provision are potential customer redress in relation to Payment Protection Insurance (PPI), interest rate swaps and breaches of the technical requirements of the Consumer Credit Act (CCA). The Bank has also made provision for conduct provisions which are individually less significant.

The calculation of these conduct and legal provisions requires significant judgement by management in determining appropriate assumptions. Other than relating to PPI and Interest Rate Hedging, the Bank is at an early stage of calculating and processing redress to customers and therefore the provisions have a high degree of sensitivity to changes in actual as opposed to forecast outcomes. This is due to a number of factors such as assumptions made to compensate for incomplete historical data, or that the Bank has further work still to do to complete its review of all past products for possible compliance or conduct breaches. Consequently, eventual outcomes could vary significantly from current estimates which represent the Bank's best estimates based on currently available information. Key assumptions made in the estimation of provisions include basis of redress, operating costs of resolving redress, level of complaints, Bank uphold rates, proactive contact and response rates and the Financial Ombudsman Service referral and uphold rates.

Where reasonably possible changes in estimates can be reliably quantified, these are discussed in each section below.

ii. Payment Protection Insurance (PPI)

A provision of £73.6m (2013: £133.8m) 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 £352m (2013: £347m).

The most significant factors behind the £5m increase are the calculation of single premium PPI redress based on full redress rather than redress based on an equivalent regular premium PPI and the application of further guidance from the Financial Ombudsman Service in relation to late fees.

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

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

Description of estimate	Current position	Future expected	Sensitivity on current position
Number of inbound valid[1] complaints	83,000	19,000	1,000 = £1.4m
Number of proactive mailings	41,000	9,000	1,000 = £1.5m
Response rate to proactive mailings	62%	70%	1% = £1.3m
Average uphold rate per valid[1] complaint	64%	63%	1% = £0.5m
Average redress per upheld complaint	£3,181	£2,015	£100 = £1.6m

1. Valid complaints excludes those complaints for which no PPI policy exists.

These assumptions remain subjective, in particular due to the uncertainty associated with future claims levels. The resulting provision represents the best estimate of all future expected costs of PPI redress. However, it is possible the eventual outcome may differ from the current estimate and if this were to be material an adjustment to the provision will be made. The provision also includes an estimate of the Bank's claims handling costs and those costs associated with claims that are subsequently referred to the Financial Ombudsman Service.

iii. Interest rate hedging past business review

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

A provision of £14.8m (2013: £33.0m) for potential interest rate swap mis-selling has been recorded. The decrease in the provision reflects the utilisation of the opening provision in the period.

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

There are a number of key assumptions within the calculation of the current provision. The key assumptions within the calculation of the current provision are the population of in scope swaps and the methodology to calculate redress provision. A potential change in overall outcomes, whilst considered unlikely, could increase the provision by £2.0m.

Notes to the Bank financial statements continued

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

2. Critical judgements and estimates continued

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

An amount of £169.4m (2013: £109.5m) has been provided regarding interest refunds following identification of breaches of the technical requirements of the CCA.

The increase in the provision reflects further interest chargeable on affected loans in accordance with relevant loan agreements which requires redressing, an updated estimate of the costs which will be incurred in delivering redress and an additional provision in relation to a further cohort of loans that have been identified as being non-compliant with the CCA. The provision will continue to increase in line with interest charged until the issue is resolved.

Assumptions for provisioning purposes are that the payment profile of loans was as per those agreed at drawdown. The provision covers all interest accrued during non-compliance to the end of December 2014.

Within the provision, operating costs of £17.6m are based upon the latest view of delivery timeframes.

v. Other conduct/compliance related provisions

Other conduct/compliance related provisions include the following:

- £17.8m (2013: £29.0m) for potential customer redress relating to the processing of first payments on certain mortgages;
- £24.0m (2013: £31.0m) relating to potential customer redress in relation to mortgage early redemption charges;
- £14.9m (2013: £26.1m) for alleged failings in the introduction of third party sales of card and identification protection products (as part of an industry wide review announced by the FCA on 27 January 2015);
- £20.0m (2013: £22.0m) relating to potential customer redress due to mortgage customer detriment;
- £34.8m (2013: £19.0m) for potential customer redress in relation to arrears fees and charges;
- £17.4m (2013: £nil) relating to packaged accounts;
- £15.0m (2013: £15.0m) relating to provision for potential conduct issues incurred but not identified;
- £7.0m (2013: £13.0m) relating to potential customer redress and other costs in relation to mortgage documentation;
- £15.2m (2013: £nil) relating to cost of mortgage redress; and
- £12.2m (2013: £10.9m) of other conduct provisions.

Key assumptions include basis of redress, operating costs of resolving redress, the level of complaints, uphold rates, proactive contact and response rates and Financial Ombudsman Service referral and uphold rates. The above provisions have a significant range of highly judgmental outcomes, the most significant of which reside within the provision for customer redress due to mortgage customer detriment and the provision for packaged accounts. Given the Bank is still in the process of identifying the population of affected customers it carries the inherent risk of forecasting for subjective final outcomes. A reasonably possible change by doubling the numbers of customers who have experienced detriment and increasing redress payments, could increase the provision for customer redress by £18.0m. Increasing the average number of fees in scope for redress for closed accounts over a longer period of time by circa 20% could increase the provision for packaged accounts by £3.6m.

c. Deferred tax

The Bank has recognised a deferred tax asset of £21.9m (2013: £25.1m restated) which includes £0.9m (2013: £nil) within a disposal group classified as held for sale. The Bank has recognised a deferred tax liability of £84.0m (2013: £103.0m restated). Deferred tax has been calculated using a tax rate of 20%.

The deferred tax asset relates to temporary differences arising on consolidation adjustments where the recoverability is not dependent on the future performance of the Bank and temporary differences in subsidiaries that are forecast to make taxable profits. The Bank has not recognised a deferred tax asset in respect of any other trading losses, capital losses or temporary differences as doubt exists over the availability of sufficient future taxable profits.

The Bank reviewed the deferred tax asset position of individual subsidiaries in the year and concluded that a deferred tax asset should be recognised in those subsidiaries which are forecast to make taxable profits against which other temporary differences can be offset under IAS 12 (Income Taxes). This, together with other deferred tax assets and liabilities previously unrecognised as at 31 December 2013, has resulted in the restatement of deferred tax assets as at 31 December 2013 of £25.1m and deferred tax liabilities of £10.5m (net increase in opening retained earnings as at 1 January 2014 of £14.6m).

d. Pensions

i. Defined contribution accounting for the Pace scheme

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

A provision of £2.9m (2013: £nil) has been recognised in relation to the annual deficit funding which the Bank has agreed to pay. This covers the period to July 2015. A further agreement on deficit funding may be reached at that point if the overall liability position has not been resolved at that time. See note 35 for further details.

Notes to the Bank financial statements continued
For the year ended 31 December 2014
All amounts are stated in £m unless otherwise indicated

2. Critical judgements and estimates continued

ii. Defined benefit accounting for the Britannia scheme

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

Following further operational separation of the Bank from the wider Co-operative Group, the Britannia scheme was recognised on the Bank's balance sheet during 2014 and is now accounted for on a defined benefit basis.

The next full (triennial) actuarial funding valuation of the Britannia Pension Scheme, with an effective date of 5 April 2014, is currently ongoing. The deadline for agreement of funding position and contributions (ie the completion of the valuation) is 5 July 2015.

Further information on the financial implications of accounting for the Britannia scheme on a defined benefit basis is disclosed in note 35.

e. Hedge accounting

The Bank reviewed its hedge accounting methodology in the year and concluded that the method for calculating hedge ineffectiveness should be revised to better align with industry practices under IAS 39 (Financial Instruments: Recognition and Measurement). This has resulted in the recognition of an accounting loss in the year and a restatement of prior years (decrease of opening retained earnings as at 1 January 2014 of £9.3m).

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

f. Interest recognition (CCA)

During 2013, technical breaches of the CCA were identified resulting in the Bank not being legally entitled to the interest on the loans subject to a breach. The Bank anticipates redressing customers and rectifying loan documentation throughout 2015, at which point the Bank becomes compliant with the CCA and the Bank can start recognising interest on the loans again.

The interest recognised on unsecured lending subject to a CCA breach was previously recognised within the interest income line, with an equal deduction for the amount recognised directly below interest income presented on the income statement. The presentation has been amended for the year and this income has not been recognised.

g. Separation provision

During November 2013, the Bank publicly announced its intention to separate from The Co-operative Group. The Bank has recognised a provision of £112.3m (2013: £39.4m) in relation to separation costs which are eligible to be provided for under IAS 37 (Provisions, Contingent Liabilities and Contingent Assets).

The separation provision represents the costs directly related to the Bank's obligation to separate from The Co-operative Group. The calculation of the separation provision requires significant judgement by management in determining appropriate assumptions. Key assumptions include the day rate which will be paid to contract staff as part of the separation of Enterprise Services Programme and the overall time it will take to achieve separation. A reasonably possible change in overall estimates of cost for key separation provision judgements could increase the provision by £12.0m.

h. Effective Interest Rate and Fair Value adjustments

When calculating the EIR to apply to an asset or liability held at amortised cost, the Bank 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 assumption in terms of impact and volatility is the assumed standard variable rate which will be in effect at the end of a fixed rate product term. 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 Bank's standard variable rate. As a measure of the sensitivity of this input, a 0.5% increase in the assumed standard variable rate in place at the end of all fixed rate products would result in a £5.2m (39%) increase in the EIR adjustment required to the loans and advances to customers balance as at 31 December 2014.

On the merger of the Bank and Britannia Building Society in August 2009, an exercise was undertaken to fair value the respective assets and liabilities of Britannia Building Society. These fair value adjustments are unwound on an EIR basis over the effective lives of the assets and liabilities. Management is required to apply significant judgement in determining the EIR assumptions which underpin the unwind profile of the fair value adjustments. The most significant assumption in terms of impact and volatility in determining the unwind profile for fair value adjustments is the remaining average lives of the related instruments.

The most significant fair value adjustment is that made to the Leek debt securities, which were valued below par upon merger. This adjustment has been unwinding towards the call date of the underlying Leek debt securities. As a measure of the sensitivity of the remaining lives on these instruments, if the Leek notes were to be redeemed one month earlier than the call date, the Leek notes fair value adjustment would decrease by £13.1m (3.4%) as at 31 December 2014, resulting in additional expense of £13.1m in the year to 31 December 2014.

Notes to the Bank financial statements continued

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

3. Restatement

In plain English:

This note provides details of restatements of the 2013 balance sheet.

Hedge accounting

In accordance with its Accounting Volatility Management Strategy, the Bank elects to make use of different hedge accounting techniques in order to eliminate (as far as possible) any profit or loss generated purely through the implementation of accounting standards (as opposed to actual economic losses).

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

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

The effect of the change, together with a £2.2m credit tax adjustment related to hedge accounting was to reduce retained earnings by £9.3m. This included a £7.0m increase to the opening balance at 1 January 2013. In 2013 the adjustments were a £14.6m charge to net interest income, a £9.8m charge to other operating income and a tax credit of £8.1m. The adjustment to the cash flow hedging reserve below includes a tax charge of £5.6m giving a net tax credit of £2.5m.

IFRIC 21 Levies

The interpretation addresses the accounting for a liability to pay a levy if that levy is within the scope of IAS 37. It also addresses the accounting for a liability to pay a levy whose timing and amount is uncertain.

The guidance provided by IFRIC 21 has led to a change in the timing for the recognition of Financial Services Compensation Scheme (FSCS) levies that impact the Bank.

The FSCS provided compensation to consumers following the collapse of a number of deposit takers. The compensation paid out to consumers is currently funded through loans from the Bank of England and HM Treasury. In order to repay the loan principal, which is not expected to be recovered, the FSCS levies participating financial institutions.

The ultimate FSCS levy to the industry as a result of the collapses cannot currently be estimated reliably as it is dependent on various uncertain factors, including the potential recoveries of assets by the FSCS and changes in the level of protected deposits and the population of FSCS members at the time.

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

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

The effect of the restatement was to reduce provisions and increase retained earnings by £26.3m, being a reduction in provisions of £24.8m and a credit to the income statement of £1.5m.

Corporate interest fair value

An interest fair value asset was recorded at the time of the merger of the Bank with the Britannia Building Society in 2009. This asset has been unwound in line with the expected behavioural lives of the assets. The Bank has reviewed the methodology and modelling of the unwind of this asset and has concluded that £23.7m of unwind related to 2013 in line with the impairment position and expected unwind profile at that point. This resulted in a £23.7m reduction in retained earnings.

Effective Interest Rate (EIR)

The Bank has reviewed its EIR models and methodologies in accordance with accounting standards and best practice. Based on this review, the Bank has amended its calculations and retrospectively restated prior years. This has resulted in a reduction in retained earnings and loans and advances to customers of £12.4m.

Deferred Tax Asset (DTA) recognition in subsidiaries

The Bank has reviewed its methodology for DTA recognition across all of the companies and has concluded that a DTA should be recognised in two of the Bank's subsidiaries, Platform Funding Limited (PFL) in 2013 and 2014 and Mortgage Agency Services Number Five Limited (MAS5) in 2013. No DTA has been recognised in MAS5 in 2014 due to the likelihood of an Optimum deleverage. All of the business of MAS5 relates to Optimum. This restatement, together with the restatement of other deferred tax positions previously unrecognised as at 31 December 2013, has resulted in a total restatement of DTA as at 31 December 2013 of £25.1m and deferred tax liabilities of £10.5m. The net impact is £14.6m, being a £12.1m increase in retained earnings and a £2.5m tax credit included in the hedge accounting adjustment of £9.3m.

Notes to the Bank financial statements continued
For the year ended 31 December 2014
All amounts are stated in £m unless otherwise indicated

3. Restatement continued

Provisions for customer redress (CCA)

Included in the net interest income adjustment is the provision for customer redress, previously reported as part of net interest income. This has been re-presented, leading to an adjustment to the net interest income line of £104.5m. In addition, provisions for conduct redress in 2013 of £90.0m, £185.1m and £31.9m included within net interest income, fee and commission income and operating expenses respectively, have been aggregated and disclosed separately on the face of the income statement.

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

Balance sheet

	Note	1 January 2013 (as reported)	Adjustment	1 January 2013 (restated)	31 December 2013 (as reported)	Adjustment	31 December 2013 (restated)
Assets							
Loans and advances to customers	18a	33,339.5	(12.4)	33,327.1	30,322.2	(36.1)	30,286.1
Fair value adjustments for hedged risk	18b	354.2	–	354.2	107.6	(1.3)	106.3
Deferred tax assets	34	159.6	2.9	162.5	–	25.1	25.1
Liabilities							
Debt securities in issue	29	4,713.7	2.5	4,716.2	4,195.3	12.3	4,207.6
Deferred tax liabilities	34	121.4	–	121.4	92.5	10.5	103.0
Provisions for liabilities and charges	33	162.7	(24.8)	137.9	576.0	(26.3)	549.7
Reserves							
Retained earnings		1,304.3			(39.4)		
Adjustment for EIR accounting			(12.4)			(12.4)	
Corporate fair value adjustment			–			(23.7)	
Deferred tax adjustment			2.9			12.1	
Adjustment for FSCS levy			24.8			26.3	
Adjustment for hedge accounting[1]			7.0			(9.3)	
		1,304.3	22.3	1,326.6	(39.4)	(7.0)	(46.4)
Cash flow hedging reserve		63.7	(9.5)	54.2	14.9	(1.8)	13.1

1. The 2013 adjustment for hedge accounting includes a £2.5m credit relating to deferred tax.

As part of the reserves restatement deferred tax assets have been recognised.

Income statement

The hedge accounting and effective interest rate (EIR) restatement gives rise to a restated presentation of items within net interest income. The IFRIC 21 levies restatement gives rise to a restated presentation of items within operating expenses.

The impact of the restatements is shown below:

	Note	31 December 2013 (as reported)	Restated	Re-presented	31 December 2013 (restated)
Net interest income – on loans and advances to customers	7	1,275.0	(23.7)	(104.5)	1,146.8
Net interest income – on financial instruments hedging assets	7	(114.4)	(14.6)	–	(129.0)
Other operating income	10	40.4	(9.8)	–	30.6
FSCS levies	33	(25.6)	1.5	–	(24.1)
Operating loss		(586.9)	(46.6)	–	(633.5)
Loss for the year before taxation		(586.2)	(46.6)	–	(632.8)
Income tax		(161.8)	17.3	–	(144.5)

The impact on regulatory capital is described in the Capital Management section on page 131.

The total impact of the IFRIC 21 levy adjustment as at 31 December 2013 is a reduction in the FSCS provision of £26.3m to £13.3m, and the charge of £1.5m. The cumulative impact on reserves is an increase of £26.3m.

Notes to the Bank financial statements continued

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

4. Segmental information

In plain English:

This note breaks down the operating results (summarised in the Bank income statement) and the assets and liabilities (summarised in the Bank balance sheet) into our main business areas. This analysis is designed to help you understand how each segment has performed and how we have allocated our shareholders' capital.

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

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

Further detail of the components of the Core and Non-core segments is provided on page 14.

	Core					Non-core				
	Retail	BaCB	Treasury	Other[1]	Total Core	Corporate CoAM	Optimum	Illius	Total Non-core	Total
2014										
Net interest income	396.3	46.1	(24.0)	13.4	431.8	9.3	43.2	(3.9)	48.6	480.4
Losses on asset sales	–	–	(2.1)	–	(2.1)	(11.1)	–	(1.2)	(12.3)	(14.4)
Non-interest income	105.2	14.9	(16.7)	–	103.4	17.2	4.7	2.8	24.7	128.1
Operating income	501.5	61.0	(42.8)	13.4	533.1	15.4	47.9	(2.3)	61.0	594.1
Direct costs	(161.9)	(15.1)	(13.3)	(9.2)	(199.5)	(18.8)	(3.1)	(4.2)	(26.1)	(225.6)
Impairment gains/(losses) on loans and advances	1.9	1.6	–	–	3.5	152.6	15.6	–	168.2	171.7
Contribution result	341.5	47.5	(56.1)	4.2	337.1	149.2	60.4	(6.5)	203.1	540.2
Operations and central costs										(369.0)
Project costs										(226.5)
Operating result										(55.3)
Intangible asset impairment										–
PPI, conduct and legal risk provisions										(101.2)
Share of post-tax profits from joint ventures										0.6
Financial Services Compensation Scheme Levies										(24.4)
Liability Management Exercise										–
Fair value amortisation										(83.9)
Loss before taxation										(264.2)
Income tax										39.0
Loss for the financial year										(225.2)

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

 Unity Trust Bank plc is registered in England and operates in the UK.

Notes to the Bank financial statements continued

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

4. Segmental information continued

	Core					Non-core				
	Retail	BaCB	Treasury	Other[1]	Total Core	Corporate CoAM	Optimum	Illius	Total Non-core	Total
2013 Restated										
Net interest income	428.1	69.5	(19.2)	8.8	487.2	16.6	(14.3)	(6.1)	(3.8)	483.4
Gains on asset sales	–	–	40.8	–	40.8	–	–	–	–	40.8
Non-interest income	123.7	14.9	(30.0)	2.2	110.8	29.3	5.7	0.7	35.7	146.5
Operating income	551.8	84.4	(8.4)	11.0	638.8	45.9	(8.6)	(5.4)	31.9	670.7
Direct costs	(180.3)	(23.7)	(11.2)	(6.8)	(222.0)	(18.2)	(2.2)	(4.7)	(25.1)	(247.1)
Impairment gains/(losses) on loans and advances	(29.8)	(5.0)	–	(1.0)	(35.8)	(446.8)	(29.5)	–	(476.3)	(512.1)
Contribution result	341.7	55.7	(19.6)	3.2	381.0	(419.1)	(40.3)	(10.1)	(469.5)	(88.5)
Operations and central costs										(408.8)
Project costs										(164.7)
Operating result										(662.0)
Intangible asset impairment										(148.4)
PPI, conduct and legal risk provisions										(411.5)
Share of post-tax profits from joint ventures										0.7
Financial Services Compensation Scheme Levies										(24.1)
Liability Management Exercise										688.3
Fair value amortisation										(75.8)
Loss before taxation										(632.8)
Income tax										(144.5)
Loss for the financial year										(777.3)

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

Notes to the Bank financial statements continued
For the year ended 31 December 2014
All amounts are stated in £m unless otherwise indicated

4. Segmental information continued

	2014	Restated 2013
Net interest income		
Total interest margin for reportable segments	**480.4**	483.4
Gains on asset sales	**1.6**	5.4
Interest fair value unwind	**(89.0)**	(69.4)
Provision for customer redress claims	**(48.0)**	(104.5)
Net interest income	**345.0**	314.9
Non-interest income		
Total non-interest income for reportable segments	**128.1**	146.5
(Losses)/gains on asset sales	**(16.0)**	35.4
Interest fair value unwind	**9.8**	0.3
Provision for customer redress claims	**–**	–
Non-interest income	**121.9**	182.2
Comprising:		
Net fee and commission income	**122.4**	147.8
Net trading income	**(2.9)**	3.8
Other operating income	**2.4**	30.6
	121.9	182.2
Operating expenses		
Total direct costs for reportable segments	**(225.6)**	(247.1)
Interest fair value unwind	**(4.7)**	(6.7)
Operations and central costs	**(369.0)**	(408.8)
Project costs	**(226.5)**	(164.7)
Re-presentation of fraud costs	**–**	4.1
Provision for customer redress claim	**3.5**	–
Impairment reclassification	**(1.5)**	–
Provision for conduct risk	**(4.4)**	–
Financial Services Compensation Scheme Levies	**(24.4)**	(24.1)
Operating expenses	**(852.6)**	(847.3)
Interest fair value unwind		
Total interest unwind for reportable segments	**(83.9)**	(75.8)
Interest margin unwind	**89.0**	69.4
Non-interest income unwind	**(9.8)**	(0.3)
Operating expenses unwind	**4.7**	6.7
Interest fair value unwind	**–**	–
Impairment gains/(losses) on loans and advances		
Total impairment gains/(losses) on loans and advances for reportable segments	**171.7**	(512.1)
Re-presentation of fraud costs	**–**	(4.1)
Impairment reclassification	**1.5**	–
Impairment gains/(losses) on loans and advances	**173.2**	(516.2)

The above table reconciles information used for management purposes, as disclosed in the detailed financial review, with statutory disclosures, in the Bank income statement on page 148.

Notes to the Bank financial statements continued

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

4. Segmental information continued

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

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

2014	Core					Non-core				
	Retail	BaCB	Treasury	Other	Total Core	Corporate CoAM	Optimum	Illius	Total Non-core	Total
Segment assets	14,611.4	620.0	9,729.4	515.4	25,476.2	3,930.1	6,822.9	–	10,753.0	36,229.2
Unallocated assets										1,069.8
Total assets for reportable segments										37,299.0
Statutory adjustments										283.9
Bank total assets										37,582.9

2014	Core					Non-core				
	Retail	BaCB	Treasury	Other	Total Core	Corporate CoAM	Optimum	Illius	Total Non-core	Total
Segment liabilities	25,562.3	2,837.0	4,523.3	468.4	33,391.0	557.4	–	–	557.4	33,948.4
Unallocated liabilities										1,109.8
Total liabilities for reportable segments										35,058.2
Statutory adjustments										510.2
Bank total liabilities										35,568.4

2013 (as restated)	Core					Non-core				
	Retail	BaCB	Treasury	Other	Total Core	Corporate CoAM	Optimum	Illius	Total Non-core	Total
Segment assets	16,790.9	844.9	10,491.4	441.0	28,568.2	5,646.1	7,326.1	162.2	13,134.4	41,702.6
Unallocated assets										1,557.9
Total assets for reportable segments										43,260.5
Statutory adjustments										123.3
Bank total assets										43,383.8

2013 (as restated)	Core					Non-core				
	Retail	BaCB	Treasury	Other	Total Core	Corporate CoAM	Optimum	Illius	Total Non-core	Total
Segment liabilities	27,899.3	3,479.0	7,645.5	394.9	39,418.7	831.0	–	–	831.0	40,249.7
Unallocated liabilities										603.8
Total liabilities for reportable segments										40,853.5
Statutory adjustments										761.8
Bank total liabilities										41,615.3

Unallocated assets are non-customer assets and liabilities that are not allocated to a particular segment. Statutory adjustments mainly relate to the reallocation of provisions, accruals and prepayments and the gross up of mark-to-market values.

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

Notes to the Bank financial statements continued

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

5. Loss before taxation

In plain English:

This note shows the amount we paid our auditors, for audit and other services during the year.

	2014 £'000	2013 £'000
Loss before taxation is stated after:		
Audit of these financial statements	**1,400**	339
Amounts receivable by the Company's auditor and its associates in respect of:		
Audit of financial statements of subsidiaries of the Company	**325**	322
Audit related assurance services	**–**	1,201
Other tax advisory services	**–**	–
Other assurance services	**530**	726
Corporate finance services	**–**	–
All other services	**455**	1,868
	2,710	4,456

Within the figures shown for 2014 is £0.3m within other assurance services relating to review work performed on the half year accounts.

Within the figures shown for 2013 are £1.2m audit related assurance services relating to work performed on the audited 2013 half year accounts, which formed part of the LME Prospectus, and 'Reporting Accountants' services in relation to the LME. A further £1.9m of fees were also incurred in 2013 for other advisory services in relation to the LME shown in all other services.

Comparatives relate to fees paid to KPMG; EY was appointed as the Bank's auditor at the AGM on 30 May 2014.

6. Directors' emoluments

In plain English:

This note gives a high level summary of Directors' pay. You can see a more detailed breakdown in the Remuneration report.

	2014 £'000	2013 £'000
Executive Directors[1]	**3,594**	2,152
Non-Executive Directors[2]	**745**	668
Compensation for loss of office	**–**	317
	4,339	3,137

1. Includes salary payments of £116k to Rodney Bulmer who ceased to be an Executive Director on 28 February 2014 when he left the Company.
2. Non-Executive Directors included fees for Richard Pym (Ex-Chairman) and Dennis Holt (Interim Chairman). In respect of service during 2014, Richard Pym received a basic fee of £137k. In addition to which the Bank agreed to pay a corporate donation as described on page 79. The total of the donations paid to charities in 2014 of £90k (2013: £67k) is included in the table above.

Retirement benefits are accruing to nil Directors (2013: one) under defined benefit schemes.

The aggregate of emoluments and amounts receivable under incentive schemes of the highest paid Director was £3,088k (2013: £1,733k).

Further details of Directors' emoluments are included in the Director's Remuneration report, which is unaudited.

In 2013 until the LME on 20 December, the Bank had a combined governance structure with its parent, The Co-operative Banking Group. 2013 Executive Directors' emoluments reflect the Bank's share of the overall emoluments receivable from The Co-operative Banking Group for qualifying service.
2013 Non-Executive Directors' emoluments reflect the overall emoluments for all services provided to The Co-operative Banking Group.

Notes to the Bank financial statements continued

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

7. Net interest income

In plain English:

This note shows the different elements of interest income and interest expense (a large contributor to our overall result). See page 9 for how the Bank makes money. The numbers in brackets are costs.

	2014	Restated 2013
Interest receivable and similar income		
On financial assets not at fair value through profit or loss:		
On loans and advances to customers	**1,052.6**	1,146.8
On loans and advances to banks	**24.1**	29.7
On investment securities	**75.8**	122.5
	1,152.5	1,299.0
On financial assets at fair value through profit or loss:		
Net interest expense on financial instruments hedging assets	**(119.7)**	(129.0)
Net interest income on financial instruments not in a hedging relationship	**19.0**	75.6
	1,051.8	1,245.6

The comparatives have been restated as described in note 3.

Included within interest receivable is £3.2m (2013: £14.2m) relating to profit on sale of investment securities – available for sale.

Interest income accrued on impaired financial assets during the year was £37.9m (2013: £43.5m). Interest due to unwinding of discount on impairment provisions relating to impaired financial assets amounted to £10.9m (2013: £10.7m).

	2014	Restated 2013
Interest expense and similar charges		
On financial liabilities not at fair value through profit or loss:		
On customer accounts	**(405.2)**	(484.3)
On bank and other deposits	**(247.8)**	(267.0)
On subordinated liabilities	**(22.8)**	(79.1)
On perpetual secured debt	**–**	(40.2)
	(675.8)	(870.6)
On financial liabilities at fair value through profit or loss:		
Net interest expense on financial instruments hedging liabilities	**(21.4)**	(24.1)
Net interest expense on financial instruments not in a hedging relationship	**(9.6)**	(36.0)
	(706.8)	(930.7)

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

The Bank's perpetual secured debt was extinguished on 20 December 2013 as part of the LME. The associated interest expense was therefore £nil during the year (2013: £40.2m).

Interest expense on bank and other deposits includes interest expense on deposits by banks and on debt securities in issue. It also includes fair value unwind on debt securities in issue of £109.2m (2013: £91.3m), further details of which are provided in note 40.

Notes to the Bank financial statements continued

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

8. Net fee and commission income/(expense)

In plain English:

This note shows more details of fees and commissions income and expense.

	2014	2013
Fee and commission income		
On items not at fair value through profit or loss	**197.2**	219.6
On trust or fiduciary activities that result from holding or investing in assets on behalf of others	**0.1**	0.3
	197.3	219.9

	2014	2013
Fee and commission expense		
On items not at fair value through profit or loss	**(74.8)**	(71.8)
On items at fair value through profit or loss	**(0.1)**	(0.3)
	(74.9)	(72.1)

9. Net trading (expense)/income

In plain English:

This note shows more details of our net trading income. This income arises from products that help our commercial customers manage their foreign exchange and interest rate risks.

	2014	2013
Foreign exchange	**6.6**	7.3
Other interest rate instruments	**(9.5)**	(3.5)
	(2.9)	3.8

Foreign exchange net trading income includes gains less losses from spot forward and forward contracts, options, and futures and translated foreign currency assets and liabilities.

Other interest rate instruments include the result of transactions in government securities, money market instruments, interest rate and currency swaps, options and other derivatives.

Notes to the Bank financial statements continued

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

10. Other operating income

In plain English:

This note shows a breakdown of our other sources of income. Most of our other income is one-off gains from selling investments and loans.

	Note	2014	Restated 2013
Profit on sale of investment securities – loans and receivables		**0.5**	39.1
Loss on sale of investment properties		**(1.2)**	–
Rent receivable from investment properties		**7.5**	8.4
Change in fair value of investment properties	23	**(4.5)**	(8.0)
Other		**0.1**	(8.9)
		2.4	30.6

The profit on sale of investment securities arose in 2013 from the restructuring of a portfolio of assets, as further described in the Detailed Financial Review. Profit on smaller disposals in the normal course of business are included in net interest income.

11. Operating expenses

In plain English:

This note breaks down the cost of running our business – our operating expenses, into various categories. We have separated out the more material items during the year in order to provide a better view of the underlying trend. Later on you will find more detail on some of these expenses (eg staff costs).

	Note	2014	Restated 2013
Operating expense			
Staff costs	12	**304.1**	274.6
Administrative expenses		**296.7**	280.4
Depreciation of property, plant and equipment	24	**13.3**	16.4
Amortisation of intangible fixed assets	22	**26.7**	24.2
Impairment of property, plant and equipment	24	**6.3**	11.3
Impairment of intangible assets	22	**3.1**	2.0
(Profit)/loss on sale of property, plant and equipment		**(0.2)**	0.5
Operating lease rentals		**25.6**	27.4
Financial Services Compensation Scheme Levies	33	**24.4**	24.1
Property provisions for liabilities and charges provided in the year	33	**2.1**	16.3
Other provisions for liabilities and charges provided in the year	33	**24.7**	35.0
Direct expenses from investment properties that generated rental income in the period		**3.6**	4.0
Direct expenses from investment properties that did not generate rental income in the period		**0.2**	0.1

Notes to the Bank financial statements continued

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

11. Operating expenses continued

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

	Note	2014	2013
Investment, integration and rationalisation costs		**40.7**	71.3
Bank separation costs	33	**72.9**	39.4
Costs incurred in bid for Lloyds Banking Group branches		**–**	10.4
Impairment of property, plant and equipment	24	**8.4**	9.9
		122.0	131.0
Total operating expenses		**852.6**	847.3

Included within investment, integration and rationalisation costs is £4.5m (2013: £2.9m) of impairment of intangible fixed assets.

The Bank separation costs included in the table above are the net impact of a charge of £94.5m (2013: £39.4m) and a utilisation of £21.6m (2013: £nil).

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

12. Staff costs

In plain English:

This note shows a breakdown of the total cost of employing our staff (including Directors) and the average number of people we employed during the year.

	2014	2013
Wages and salaries	**180.6**	190.3
Social security costs	**16.0**	14.6
Pension costs:		
Defined benefit plans	**4.9**	0.2
Defined contribution plans	**26.1**	28.5
Other staff costs	**76.5**	41.0
	304.1	274.6

Average number of employees

The average number of persons working for the Bank during the year is as follows:

	No. of employees 2014	No. of employees 2013
Full time	**4,772**	5,646
Part time	**1,630**	1,880
	6,402	7,526

Employees of the Bank were employed by CFS Management Services Limited (CFSMS) until 20 December 2013 and staff costs recharged to the Bank. At the beginning of 2014, the majority of the Bank's employees had their employment contracts transferred from CFSMS to The Co-operative Bank plc. The transfer was required to support the legal separation of the Bank from The Co-operative Group. This transfer took place under the Transfer of Undertakings (Protection of Employment) Regulations 2006.

Notes to the Bank financial statements continued

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

13. Income tax

In plain English:

Income tax is the tax charge on our trading activities during the year. The following note shows the breakdown of income tax between the current tax (the tax we have to pay to or reclaim from HM Revenue & Customs or other companies in the tax group) and the deferred tax (tax that may become payable at some point in the future). It also explains why our tax rate is different from the UK standard corporation tax rate. Tax is usually an expense, so this note shows tax credits in brackets.

	Note	2014	Restated 2013
Current tax			
Current year		**(22.3)**	(9.9)
Prior year		**7.8**	22.8
Total current tax		**(14.5)**	12.9
Deferred tax			
Current year	34	**(24.5)**	(13.3)
Write off of prior year deferred tax asset	34	**–**	148.2
Prior year	34	**–**	(3.3)
Total deferred tax		**(24.5)**	131.6
Total tax (credit)/charge		**(39.0)**	144.5

In addition to the above, included within other comprehensive income is a current tax charge of £12.5m (2013: tax credit of £13.3m restated) and a deferred tax charge of £8.7m (2013: tax credit of £12.5m restated).

Further information on deferred tax is presented in note 34. The tax on the Bank's loss before taxation differs from the theoretical amount that would arise using the corporation tax rate in the UK as follows:

	Note	2014	Restated 2013
Loss before taxation		**(264.2)**	(632.8)
Tax calculated at a rate of 21.49% (2013: 23.25%)		**(56.8)**	(147.1)
Effects of:			
Unrecognised deferred tax		**22.7**	115.9
Discount of group relief debtor		**(9.7)**	56.9
Adjustments to tax charge in respect of prior periods		**7.7**	19.5
Expenses not deductible for tax purposes		**(4.4)**	25.1
Change in rate of deferred tax		**1.8**	29.9
Other differences		**(1.8)**	0.4
Depreciation of capital expenditure not qualifying for capital allowances		**1.5**	2.5
Write off of prior year deferred tax asset	34	**–**	148.1
Non-taxable income		**–**	(116.3)
Difference in the tax rate at which current year group relief is expected to be recoverable		**–**	9.6
		(39.0)	144.5

The comparatives for 2013 have been restated as described in note 3. This results in an increase in unrecognised deferred tax of £2.0m and a decrease in the write off of prior year deferred tax assets of £9.4m. Amounts receivable from The Co-operative Group for tax losses surrendered and changes in that amount are recorded as an adjustment to the tax expense.

Notes to the Bank financial statements continued

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

14. Earnings per share

In plain English:

Earnings per share shows the overall profit or loss (shown in brackets) for each share that our shareholders own.

Basic earnings per share is calculated by dividing the net loss attributable to equity shareholders of the Bank by the weighted average number of ordinary shares in issue during the year.

	Note	2014	Restated 2013
Loss attributable to equity shareholders of the Bank		**(226.6)**	(778.2)
Ordinary shares in issue (millions)			
At the beginning of the year		**250.0**	8,200.0
Shares cancelled	39	**–**	(8,200.0)
Issue of new ordinary shares	39	**200.5**	250.0
Issue of bonus shares		**1.0**	–
At the end of the year		**451.5**	250.0
Weighted average number of ordinary shares in issue (millions)		**368.6**	368.6
Basic losses per share (expressed in pence per share)		**(61.48)p**	(211.12)p

201.5m new shares were issued as part of the capital raising which was completed in May 2014, see note 39 for further details.

The 2013 weighted average number of shares has been adjusted for the 2013 cancellation of 8.2bn ordinary shares and the 2014 bonus share issue as required by IAS 33 (Earnings per share). 8.2bn ordinary shares were cancelled in 2013 as part of the LME.

Coming up:

The next few notes are designed to give you more information on our balance sheet assets. You will find explanations and tables breaking down the numbers into more detail.

Notes to the Bank financial statements continued

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

15. Non-current assets held for sale

a) Non-current assets classified as held for sale

	Note	Non-current assets	Disposal group	**2014**	2013
Property, plant and equipment	24	9.1	41.0	**50.1**	–
Intangible assets	22	–	0.3	**0.3**	–
Loans and advances to customers	18a	–	323.4	**323.4**	–
Cash and cash equivalents		–	9.1	**9.1**	–
Other receivables		–	4.4	**4.4**	–
		9.1	378.2	**387.3**	–

b) Liabilities directly associated with non-current assets classified as held for sale

	Note	Disposal group	**2014**	2013
Other liabilities, accruals and deferred income		6.6	**6.6**	–
Current tax liabilities		1.0	**1.0**	–
Provision for liabilities and charges	33	0.3	**0.3**	–
		7.9	**7.9**	–

The non-current assets presented as held for sale relate to two transactions which are expected to complete in 2015 and have been approved by management:

i. The sale of a significant proportion of the ATM estate, in accordance with a sale agreement signed in November 2014. The ATMs are to be migrated to the purchaser on a phased basis with the Bank retaining the risks and rewards of ownership up to the point of transfer of each individual ATM; and

ii. The sale of Britannia House.

No impairment losses or gains were recognised on classification of Britannia House or ATMs as held for sale assets.

The disposal groups relate to three transactions which are highly likely to complete in 2015 and have been approved by the Board:

i. The proposed sale of Western Mortgage Services Limited (WMSL) shares or business as part of the Bank's outsourcing of its mortgage processing services for all its residential mortgages. This proposed transaction was announced by the Bank on 11 November 2014;

ii. The sale of Southside Regeneration Limited (SRL) as part of a larger deleveraging deal; and

iii. The completion of a renewable energy asset portfolio sales contract which was exchanged during December 2014, under which the underlying borrowers cannot reasonably withhold consent.

No impairment losses or gains were recognised on classification as disposal groups.

Except for the renewable energy asset portfolio which is included in Corporate CoAM, all of the above disposal groups and held for sale assets are included within the Other Core segment in note 4.

Notes to the Bank financial statements continued

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

16. Cash and balances at central banks

In plain English:

This note details our most liquid assets – cash in our tills and balances with the Bank of England.

	2014	2013
Cash in hand	**218.0**	274.9
Balances with the Bank of England other than mandatory reserve deposits	**4,489.5**	5,077.7
Included in cash and cash equivalents	**4,707.5**	5,352.6
Mandatory reserve deposits with the Bank of England	**57.8**	66.2
	4,765.3	5,418.8

Mandatory reserve deposits are not available for use in the Bank's day-to-day operations, are non-interest bearing and are not included in cash and cash equivalents.

17. Loans and advances to banks

In plain English:

This note shows cash in transit with other banks and the amounts we have lent to other banks to earn interest income.

	2014	2013
Items in course of collection from other banks	**63.3**	105.1
Placements with other banks	**682.2**	529.5
Included in cash and cash equivalents	**745.5**	634.6
Other loans and advances to banks	**862.9**	959.8
	1,608.4	1,594.4

18. a) Loans and advances to customers

In plain English:

This note shows the amounts we have lent to customers to earn interest income. Where we have objective evidence that loan amounts will not be repaid, we have made a provision to take account of the likely loss. The cumulative loan impairment charges are shown in this note. Any additional loan impairment charges that arose during the period are shown in the income statement.

	Classified as held for sale[1]	Not classified as held for sale	Total 2014	Restated 2013
Gross loans and advances	**323.4**	**25,917.3**	**26,240.7**	31,238.5
Less: allowance for losses	**–**	**(539.9)**	**(539.9)**	(952.4)
	323.4	**25,377.4**	**25,700.8**	30,286.1

1. See note 15 for details of the loans and advances classified as held for sale. No loans and advances were classified as held for sale at 31 December 2013.

Loans and advances to customers include £182.7m (2013: £134.2m) of financial assets at fair value through profit or loss designated at initial recognition to eliminate or significantly reduce a measurement or recognition inconsistency, and £3.9m of financial assets held for trading (2013: £nil). Of these, £78.4m (2013: £62.9m) are secured by real estate collateral.

Loans and advances to customers include £7,899.6m (2013: £10,111.9m) securitised under the Bank's securitisation and covered bond programmes. The Bank remains exposed to substantially all of the risks and rewards of ownership of these assets. Included within the Bank's deposits by banks are £10.1m (2013: £500.3m) of loans from external third parties and within the Bank's debt securities in issue are £2,876.5m (2013: £3,703.4m) of fixed and floating rate notes, all secured on these mortgage assets.

Loans and advances to customers have been restated as detailed in note 3.

Notes to the Bank financial statements continued
For the year ended 31 December 2014
All amounts are stated in £m unless otherwise indicated

18. a) Loans and advances to customers continued

Concentration of exposure
The Bank's exposure is virtually all within the UK. Further information on the concentration of exposure is included within the risk management disclosures.

Allowance for losses on loans and advances

	Core		Non-core		
	Individual	Collective	Individual	Collective	Total
2014					
At the beginning of the year	10.7	167.8	724.5	49.4	952.4
Balances with debt collection agencies	–	39.6	–	–	39.6
Release against profits for the year	(1.5)	(3.3)	(147.3)	(20.3)	(172.4)
Amounts written off	(4.6)	(89.9)	(174.4)	–	(268.9)
Unwind of discount allowance	(0.1)	(4.2)	(6.6)	–	(10.9)
Interest charged on impaired loans	–	–	0.1	–	0.1
At the end of the year	4.5	110.0	396.3	29.1	539.9

	2014
Net impairment charge shown in income statement	(173.2)
Amounts recovered against amounts previously written off	2.3
Provision against fair value adjustment for hedged risk	(1.5)
Release against profits shown above	(172.4)

The net impairment credit in the Bank's income statement is £173.2m (2013 charge: £516.2m). This includes amounts recovered by the Bank of £2.3m (2013: £1.1m) against amounts previously written off.

The impairment charge also includes a provision of £1.5m (2013: £9.8m) made against fair value adjustments for hedged risk during the year (as shown in the fair value adjustments for hedged risk tables).

Core provisions are analysed in further detail below:

	Core						
	Retail		BaCB		Other[1]		Total
	Individual	Collective	Individual	Collective	Individual	Collective	Core
2014							
At the beginning of the year	2.8	161.9	0.5	5.3	7.4	0.6	178.5
Balances with debt collection agencies	–	39.6	–	–	–	–	39.6
(Release)/charge against profits	(1.3)	(0.1)	1.3	(3.1)	(1.5)	(0.1)	(4.8)
Amounts written off	(0.5)	(89.9)	(0.4)	–	(3.7)	–	(94.5)
Unwind of discount allowance	–	(4.2)	–	–	(0.1)	–	(4.3)
At the end of the year	1.0	107.3	1.4	2.2	2.1	0.5	114.5

1. 'Other' relates to Unity Trust Bank.

A review of the Bank's relationships with debt collection agencies in 2014 concluded that the Bank had substantially retained all of the risks and rewards associated with such relationships. The related gross receivables of £41.4m and associated allowance of £39.6m have therefore been recognised as at 31 December 2014. The comparative information has not been adjusted on the grounds of materiality. Had the comparative information been adjusted, the net Loans and Advances to Customers balance and Total Equity would have increased by £1.8m and £1.8m respectively.

Notes to the Bank financial statements continued

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

18. a) Loans and advances to customers continued

Non-core provisions are analysed in further detail below:

	Non-core				
	Corporate		Optimum		Total
	Individual	Collective	Individual	Collective	Non-core
2014					
At the beginning of the year	**698.4**	**40.0**	**26.1**	**9.4**	**773.9**
(Release)/charge against profits	**(129.0)**	**(23.3)**	**(18.3)**	**3.0**	**(167.6)**
Amounts written off	**(176.1)**	**–**	**1.7**	**–**	**(174.4)**
Unwind of discount allowance	**(6.6)**	**–**	**–**	**–**	**(6.6)**
Interest charged on impaired loans	**0.1**	**–**	**–**	**–**	**0.1**
At the end of the year	**386.8**	**16.7**	**9.5**	**12.4**	**425.4**

	Core		Non-core		
	Individual	Collective	Individual	Collective	Total
2013 restated					
At the beginning of the year	9.4	175.2	434.8	23.6	643.0
Charge against profits for the year	2.4	38.0	441.3	25.8	507.5
Amounts written off	(0.9)	(41.8)	(145.1)	–	(187.8)
Unwind of discount allowance	(0.2)	(3.6)	(6.9)	–	(10.7)
Interest charged on impaired loans	–	–	0.4	–	0.4
At the end of the year	10.7	167.8	724.5	49.4	952.4

	2013
Net impairment charge shown in income statement	516.2
Amounts recovered against amounts previously written off	1.1
Provision against fair value adjustment for hedged risk	(9.8)
Charge against profits shown above	507.5

Core provisions are analysed in further detail below:

	Core						
	Retail		BaCB		Other[1]		Total
	Individual	Collective	Individual	Collective	Individual	Collective	Core
2013							
At the beginning of the year	2.7	173.3	0.3	1.1	6.4	0.8	184.6
Charge/(release) against profits for the year	0.6	32.9	0.6	5.3	1.2	(0.2)	40.4
Amounts written off	(0.5)	(40.7)	(0.4)	(1.1)	–	–	(42.7)
Unwind of discount allowance	–	(3.6)	–	–	(0.2)	–	(3.8)
At the end of the year	2.8	161.9	0.5	5.3	7.4	0.6	178.5

1. 'Other' relates to Unity Trust Bank.

The overall write back of impairment is largely due to improved credit conditions and the strategic disposal of Non-core assets at favourable prices.

Notes to the Bank financial statements continued

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

18. a) Loans and advances to customers continued

Non-core provisions are analysed in further detail below:

	Non-core				
	Corporate		Optimum		
	Individual	Collective	Individual	Collective	Total Non-core
2013					
At the beginning of the year	426.9	20.5	7.9	3.1	458.4
Charge against profits for the year	417.8	19.5	23.5	6.3	467.1
Amounts written off	(139.8)	–	(5.3)	–	(145.1)
Unwind of discount allowance	(6.9)	–	–	–	(6.9)
Interest charged on impaired loans	0.4	–	–	–	0.4
At the end of the year	698.4	40.0	26.1	9.4	773.9

Loans and advances to customers include finance lease receivables:

	2014	2013
Gross investment in finance leases may be analysed as follows:		
No later than one year	**14.3**	18.4
Later than one year and no later than five years	**47.8**	55.4
Later than five years	**51.0**	53.6
	113.1	127.4
Unearned future finance income on finance leases	**(30.4)**	(32.7)
Net investment in finance leases	**82.7**	94.7
The net investment in finance leases may be analysed as follows:		
No later than one year	**9.0**	12.8
Later than one year and no later than five years	**33.1**	39.2
Later than five years	**40.6**	42.7
	82.7	94.7

There are no unguaranteed residual values for any of the finance leases.

The Bank enters into finance lease and hire purchase arrangements with customers in a wide range of sectors including transport, retail and utilities. The accumulated allowance for uncollectible minimum lease payments receivable is £nil (2013: £0.6m).

Notes to the Bank financial statements continued

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

18. b) Fair value adjustments for hedged risk

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

	2014	Restated 2013
Gross fair value adjustments for hedged risk	**196.8**	153.1
Less: impairment provision	**(48.3)**	(46.8)
	148.5	106.3

The comparatives have been restated as described in note 3.

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

	2014	2013
At the beginning of the year	**46.8**	37.0
Charge against profits	**1.5**	9.8
At the end of the year	**48.3**	46.8

19. Investment securities

In plain English:

We hold a number of different investments in the form of securities (ie listed & unlisted shares and bonds). We are obliged to categorise and value these as follows:

- Loans and receivables: These are included in the balance sheet at amortised cost less any impairment.
- Available for sale: These are investments that are not included in another category (above or below). They are revalued at each balance sheet date (fair value). Any increases in value are taken directly to equity, so do not appear in the income statement (see the statement of comprehensive income).
- Fair value through profit or loss: These are investments that we hold short term. They are revalued at each balance sheet date (fair value). Any increases in value are profits and reductions in value are losses, both of which are recorded in the income statement.
- Held for trading: These were our trading assets, and were revalued (mark-to-market). We no longer hold investment securities for trading purposes.

a) Loans and receivables

	2014	2013
Loans and receivables:		
Listed	**18.1**	23.6
Unlisted	**–**	–
	18.1	23.6
Less: allowance for losses	**–**	–
	18.1	23.6

The movement in investment securities – loans and receivables excluding interest amounts is summarised as follows:

	2014	2013
At the beginning of the year	**23.6**	294.7
Disposals and maturities	**(6.9)**	(283.4)
Exchange adjustments	**(0.5)**	0.9
Fair value movements through income or expense	**–**	(9.2)
Amortisation	**–**	20.6
At the end of the year	**16.2**	23.6

Notes to the Bank financial statements continued
For the year ended 31 December 2014
All amounts are stated in £m unless otherwise indicated

19. Investment securities continued

b) Available for sale

	2014	2013
Available for sale:		
Listed	**3,022.4**	2,497.2
Unlisted	**145.1**	255.2
	3,167.5	2,752.4
Less: allowance for losses	**–**	(20.0)
	3,167.5	2,732.4
Included in cash and cash equivalents	**115.0**	105.0

The movement in investment securities – available for sale excluding interest amounts, is summarised as follows:

	2014	2013
At the beginning of the year	**2,716.5**	3,775.5
Acquisitions	**1,940.1**	2,346.0
Disposals and maturities	**(1,670.0)**	(3,271.3)
Exchange adjustments	**–**	(0.9)
Fair value movements through equity	**71.1**	(32.7)
Fair value movements through income or expense	**82.7**	(105.0)
Amortisation	**(8.9)**	(13.6)
Release and utilisation of impairment provision	**20.0**	18.5
At the end of the year	**3,151.5**	2,716.5

Impairment analysis of investment securities – available for sale

	2014	2013
At the beginning of the year	**20.0**	39.0
Release for the year	**(1.1)**	–
Utilised during the year	**(18.9)**	(18.5)
Exchange adjustments	**–**	(0.5)
At the end of the year	**–**	20.0

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

c) Fair value through profit or loss

	2014	2013
Fair value through profit or loss:		
Listed	**1,236.9**	1,743.4
Unlisted	**–**	–
	1,236.9	1,743.4
Less: allowance for losses	**–**	–
	1,236.9	1,743.4

Notes to the Bank financial statements continued
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19. Investment securities continued
The movement in investment securities – fair value through profit or loss excluding interest amounts, is summarised as follows:

	2014	2013
At the beginning of the year	**1,730.9**	1,830.6
Reclassified to fair value through profit or loss	**–**	447.7
Acquisitions	**338.9**	2,120.9
Disposals and maturities	**(893.1)**	(2,632.9)
Exchange adjustments	**–**	(0.1)
Fair value movements through profit or loss	**53.4**	(35.3)
At the end of the year	**1,230.1**	1,730.9

d) Held for trading
As at December 2014, no held for trading investment securities were held (2013: £nil).

The movement in investment securities – held for trading excluding interest amounts, may be summarised as follows:

	2014	2013
At the beginning of the year	**–**	954.3
Reclassified to fair value through profit or loss	**–**	(447.7)
Acquisitions	**–**	30.7
Disposals and maturities	**–**	(530.9)
Exchange movements	**–**	0.7
Fair value movements through profit or loss	**–**	(7.1)
At the end of the year	**–**	–

e) Analysis of investment securities by issuer

	2014	2013
Investment securities issued by public bodies:		
Government securities	**3,210.3**	3,064.3
Other public sector securities	**339.7**	580.5
	3,550.0	3,644.8
Investment securities issued by other issuers:		
Bank and building society certificates of deposits	**145.1**	235.2
Other debt securities:		
Other floating rate notes	**709.3**	595.8
Mortgage backed securities	**18.1**	23.6
	727.4	619.4
	4,422.5	4,499.4

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

Notes to the Bank financial statements continued

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

20. Derivative financial instruments

In plain English:

A derivative is a financial instrument used to manage risk. Its value changes over time in response to underlying variables such as interest rates or exchange rates. These contracts are for a fixed period. Our derivatives include a variety of financial contracts, many of which are designed to help customers manage their interest rate and currency risks. We also use derivatives ourselves, to manage our own interest rate and foreign currency risk.

The value of the derivative contracts that you can see in our balance sheet is determined by fluctuations in the underlying item. The derivative will appear as an asset if we have benefited from the contract by the balance sheet date and as a liability if we have not benefited.

The value of these derivatives can be volatile as market conditions change on a daily basis.

The Bank has entered, as principal, into various derivatives either as a trading activity, which includes proprietary transactions and customer facilitation, or as a hedging activity for the management of interest rate risk, equity risk and foreign exchange rate risk. Positive and negative fair values have not been netted off as the Bank does not have a legal right of offset.

Derivatives held for trading purposes

The trading transactions are wholly interest rate related contracts including swaps, caps and floors, forward rate agreements and exchange traded futures. Trading transactions include derivatives where the Bank enters into a transaction to accommodate a customer together with the corresponding hedge transaction. The Bank no longer holds derivatives for trading purposes.

Non-trading derivatives

Non-trading transactions comprise derivatives held for hedging purposes to manage the asset and liability positions of the Bank. Derivatives used to manage interest rate related positions include swaps, caps and floors, forward rate agreements and exchange traded futures. The foreign exchange rate positions are managed using forward currency transactions and swaps. Equity risk is managed using equity swaps.

During the year the Bank has entered into fair value hedges to mitigate price movements due to interest rate sensitivities.

	2014 Fair value		Restated 2013 Fair value	
	Assets	**Liabilities**	Assets	Liabilities
Derivatives held for non-trading purposes				
Derivatives designated as cash flow hedges:				
Interest rate swaps	**46.1**	**(16.7)**	37.9	(56.0)
Derivatives designated as fair value hedges:				
Interest rate swaps	**0.6**	**(341.2)**	52.5	(289.4)
Cross currency interest rate swaps	**173.4**	**(17.8)**	213.4	(24.6)
Derivatives held for non-trading purposes for which hedge accounting has not been applied:				
Interest rate swaps	**198.2**	**(174.2)**	144.5	(165.0)
Forward currency transactions	**0.6**	**(0.6)**	3.2	(1.4)
OTC interest rate options	**0.9**	**(0.1)**	0.6	(2.2)
OTC equity options	**–**	**–**	0.3	–
Equity swaps	**50.9**	**(1.1)**	103.4	–
Total derivative assets/(liabilities) held for non-trading purposes	**470.7**	**(551.7)**	555.8	(538.6)
Total recognised derivative assets/(liabilities)	**470.7**	**(551.7)**	555.8	(538.6)

2013 numbers have been restated. Refer to note 3 for further information.

Notes to the Bank financial statements continued

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

20. Derivative financial instruments continued

The derivatives designated as cash flow hedges are interest rate swaps and futures used to hedge interest rate risk in the Bank's retail operations. Cash flows are hedged by quarterly time periods for durations up to 10 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 2014 was £3.9m (2013: £4.4m). CVAs and DVAs are not applied to derivatives that are fully cash collateralised.

21. Equity shares

In plain English:

As well as the investment securities that we detailed in note 19, we also have a smaller amount of other investments (in shares of companies). These are detailed below.

	2014	2013
Investment securities:		
Listed	**0.1**	0.1
Unlisted	**2.7**	5.7
	2.8	5.8
Included above are the following trade investments:		
VocaLink Holdings Limited – 4,416,165 ordinary shares of £1 each (2013: 4,416,165)[1]	**2.7**	5.7

1. During 2014 this investment was revalued by £3m.

Equity shares are classified as available for sale.

Notes to the Bank financial statements continued
For the year ended 31 December 2014
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22. Intangible assets

In plain English:

An intangible asset is an asset without any physical substance but which has a long term value to our business. Our intangible assets relate to internally generated software development costs and the stable deposit base that provide a low-cost source of funding that we acquired with Britannia (core deposit intangible). We reduce the balance sheet value of these assets on a systematic basis by way of amortisation, over a period of up to 10 years. Amortisation is recorded in the income statement. We also assess assets for impairment. Impairments are also shown in the income statement.

	2014			2013		
	Internally generated intangible assets	**Other intangible assets**	**Total**	Internally generated intangible assets	Other intangible assets	Total
Cost						
At the beginning of the year	**452.6**	**46.0**	**498.6**	440.0	46.0	486.0
Additions	**36.4**	**–**	**36.4**	13.7	–	13.7
Disposals	**(8.8)**	**–**	**(8.8)**	(1.1)	–	(1.1)
Impairment	**(7.6)**	**–**	**(7.6)**	–	–	–
Transfer to non-current assets held for sale (note 15)	**(2.9)**	**–**	**(2.9)**	–	–	–
At the end of the year	**469.7**	**46.0**	**515.7**	452.6	46.0	498.6
Accumulated amortisation and impairment						
At the beginning of the year	**365.9**	**22.0**	**387.9**	207.3	15.5	222.8
Charge for the year	**22.2**	**4.5**	**26.7**	19.7	4.5	24.2
Impairment for the year	**–**	**–**	**–**	140.0	2.0	142.0
Disposals	**–**	**–**	**–**	(1.1)	–	(1.1)
Transfer to non-current assets held for sale (note 15)	**(2.6)**	**–**	**(2.6)**	–	–	–
At the end of the year	**385.5**	**26.5**	**412.0**	365.9	22.0	387.9
Net book value						
At the end of the year	**84.2**	**19.5**	**103.7**	86.7	24.0	110.7
At the beginning of the year	86.7	24.0	110.7	232.7	30.5	263.2

Internally generated intangible assets consist of software development costs.

Other intangible assets consist of a core deposit intangible of £19.5m (2013: £24.0m).

Internally generated assets include £26.7m (2013: £8.5m) of assets in the course of construction.

Of the total 2014 impairment charge of £7.6m, £3.1m is disclosed as impairment of brand intangible assets, with the remaining £4.5m included within investment, integration and rationalisation costs within note 11.

The total impairment charge for 2013 was £148.4m. This charge was made up of impairment of internally generated intangible assets of £140.0m, other intangible assets of £2.0m and assets in the course of construction not yet capitalised of £6.4m.

Notes to the Bank financial statements continued
For the year ended 31 December 2014
All amounts are stated in £m unless otherwise indicated

23. Investment properties

In plain English:

We held a number of properties for investment purposes through Illius Properties Limited (which was a subsidiary of the Bank and was sold during the year), either for earning rental income or to make capital gains. These properties were revalued each year to reflect their fair (market) value and any changes in these values each year recorded as either a gain (profit) or a loss in other operating income in the income statement. The rental income is also included within other operating income in the Bank income statement as shown in note 10.

	Note	2014	2013
Fair value			
At the beginning of the year		**164.1**	173.0
Additions – other expenditure		**0.2**	0.4
Disposals		**(157.7)**	(1.3)
Changes in fair value	10	**(4.5)**	(8.0)
At the end of the year		**2.1**	164.1

At the year end, investment properties relates solely to the Bank's stake in residential shared ownership properties. Shared ownership properties are carried at fair value, being the price at which the property could be exchanged between knowledgeable, willing parties in an arm's length transaction, measured under a combination of level 2 and level 3 of the fair value hierarchy (see note 40). Fair value is calculated by using recent valuations of individual assets within the portfolio, indexed linked to the balance sheet date using the relevant regional house price index and the resulting profit/loss is recorded in the Bank's income statement.

Illius Properties Limited was sold on 28 November 2014. The loss on sale was £1.2m.

All investment properties are held to generate rental income until such time that the Bank considers it appropriate to realise its investment.

Included in the Bank's other operating income for the year is £7.5m (2013: £8.4m) of rental income relating to investment properties (note 10).

Notes to the Bank financial statements continued

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

24. Property, plant and equipment

In plain English:

The note below gives a breakdown of the type of assets in use in our business, eg branches and computer equipment. We reduce the balance sheet value of these assets on a systematic basis by way of depreciation. Depreciation is therefore an expense in the income statement.

2014	Land and buildings	Leasehold improvements	Computers and other equipment	Assets in the course of construction	Total
Cost					
At the beginning of the year	83.0	25.1	142.5	13.7	264.3
Additions	12.7	–	18.2	7.6	38.5
Disposals	(2.1)	(0.1)	(10.7)	–	(12.9)
Transfer between categories	–	–	9.2	(9.2)	–
Classified as held for sale (note 15)	(47.4)	–	(17.2)	–	(64.6)
Impairment	–	–	–	(11.1)	(11.1)
At the end of the year	46.2	25.0	142.0	1.0	214.2
Accumulated depreciation					
At the beginning of the year	18.6	22.5	108.0	–	149.1
Charge for the year	0.8	1.9	10.6	–	13.3
Disposals	(0.3)	(0.1)	(4.4)	–	(4.8)
Classified as held for sale (note 15)	(6.9)	–	(7.6)	–	(14.5)
Impairment	2.9	–	0.7	–	3.6
At the end of the year	15.1	24.3	107.3	–	146.7
Net book value					
At the end of the year	31.1	0.7	34.7	1.0	67.5
At the beginning of the year	64.4	2.6	34.5	13.7	115.2

Notes to the Bank financial statements continued

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

24. Property, plant and equipment continued

2013	Land and buildings	Leasehold improvements	Computers and other equipment	Assets in the course of construction	Total
Cost					
At the beginning of the year	55.4	25.2	153.9	16.1	250.6
Additions	27.9	–	6.9	6.8	41.6
Disposals	(0.3)	(0.1)	(16.7)	–	(17.1)
Impairment	–	–	(1.6)	(9.2)	(10.8)
At the end of the year	83.0	25.1	142.5	13.7	264.3
Accumulated depreciation					
At the beginning of the year	7.8	18.4	111.0	–	137.2
Charge for the year	1.1	4.2	11.1	–	16.4
Disposals	(0.2)	(0.1)	(14.6)	–	(14.9)
Impairment for the year	9.9	–	0.5	–	10.4
At the end of the year	18.6	22.5	108.0	–	149.1
Net book value					
At the end of the year	64.4	2.6	34.5	13.7	115.2
At the beginning of the year	47.6	6.8	42.9	16.1	113.4

Included within the 2013 total assets, the Bank did not hold legal title to £44.0m, but the Directors were of the opinion that the assets met the accounting criteria of an asset for the Bank. The assets were therefore accounted for on the Bank's balance sheet.

As part of the separation of the Bank from the Group, in November 2014, the Bank purchased the legal title of all Bank specific assets held by CFSMS (shared assets remained with CFSMS). The carrying value of these assets on the balance sheet at 31 December 2014 is £42.9m, of which £9.1m has been classified as held for sale.

	2014	2013
The net book value of land and buildings comprises:		
Freehold	**30.5**	63.8
Leasehold	**0.6**	0.6
	31.1	64.4

25. Other assets

In plain English:

This note gives you more detail on other amounts that we are owed at the balance sheet date.

	2014	2013
Amounts recoverable within one year:		
Trade debtors	**24.3**	29.7
Other assets	**0.5**	21.4
Amounts owed by The Co-operative Group	**64.7**	23.1
Amounts owed by The Co-operative Banking Group Limited	**–**	303.2
Amounts recoverable after more than one year:		
Amounts owed by The Co-operative Group	**98.1**	103.5
	187.6	480.9

Amounts owed by The Co-operative Group includes group tax relief recoverable of £126.8m (2013: £126.6m). The £303.2m owed by The Co-operative Banking Group (a subsidiary of The Co-operative Group) in 2013 represented the commitment to contribute £313.0m of CET1 on a discounted basis. This amount was fully paid in December 2014. Further details of the related party relationship of the Bank with The Co-operative Group and its undertakings are contained in note 38.

Notes to the Bank financial statements continued

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

26. Prepayments and accrued income

In plain English:

Prepayments arise when we pay expenses in advance (eg insurance premiums). In effect, the prepaid amount is owed back to us until we incur the expense. Accrued income is income which has been earned but not yet received in cash.

	2014	2013
Other:		
Amounts recoverable within one year	**6.2**	7.4
Amounts recoverable after more than one year	**6.0**	9.1
	12.2	16.5

Coming up:

The next few notes are designed to give you more information on our balance sheet liabilities. You will find explanations and tables breaking down the numbers into more detail.

27. Deposits by banks

In plain English:

Our main source of funding is retail deposits (customer accounts) but we also take deposits from other banks, on which we pay interest. The interest expense is included in the income statement (see the net interest income note 7).

	2014	2013
Items in course of collection	**37.9**	40.9
Deposits from other banks	**577.5**	2,716.6
	615.4	2,757.5

Included within deposits from other banks are liabilities of £nil (2013: £1,028.3m) secured on investment securities with a carrying value of £nil (2013: £1,004.4m) which have been sold under sale and repurchase agreements (note 40).

28. Customer accounts – capital bonds

In plain English:

We hold customers' savings in the form of capital bonds upon which we pay out returns that are linked to stock market performance. The Bank uses derivatives to control the cost of this funding (recorded as interest expense in the Bank income statement) by hedging stock market risk.

	2014	2013
Retail	**263.8**	538.1

The capital bonds are fixed term customer accounts with returns based on the movement in an index (eg FTSE 100) over the term of the bond. They have been designated on initial recognition at fair value through profit or loss and are carried at fair value.

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

The maximum amount the Bank would contractually be required to pay at maturity for all the capital bonds is £264.3m (2013: £539.2m).

The Bank uses swaps to create economic hedges against all of its capital bonds. The gain on capital bonds in the income statement for the year is £37.8m (2013: £21.3m). However, taking into account changes in fair value of the associated swaps, the net impact to the income statement for the year is a loss of £1.5m (2013: gain of £0.9m).

Notes to the Bank financial statements continued

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

29. Debt securities in issue

In plain English:

This note gives you more information on our debt securities (bonds and similar instruments) used as part of our wholesale funding programme. The majority are bonds with a variety of fixed and variable interest rates which we use to fund mortgages.

	2014	Restated 2013
Certificates of deposit	**–**	5.1
Fixed and floating rate notes	**3,443.6**	4,202.5
	3,443.6	4,207.6

The Bank has entered into cross currency interest rate swaps that protect it from changes in exchange rates and interest rates on its debt securities in issue. Changes in the fair values of these swaps are largely offset by changes in the sterling equivalent carrying value of the debt securities in issue.

Debt securities in issue include fixed and floating rate notes, the majority of which are secured on portfolios of variable and fixed rate mortgages. Certain of these notes (securitisations) are redeemable in part from time to time, such redemptions being limited to the net capital received from mortgagors in respect of the underlying assets. There is no obligation for the Bank to make good any shortfall out of general funds. Other notes (covered bonds secured, certificates of deposit and euro medium term notes – unsecured) require the Bank to repay contractual amounts due on specified maturity dates.

Debt securities in issue has been restated as described in note 3.

30. Other borrowed funds

In plain English:

This note describes our long term wholesale funding. This is now all subordinated debt which means that it would rank lower in the pay-out order if we were ever to be wound-up.

	2014	2013
Fixed rate subordinated notes 2023	**206.0**	206.0
Issue costs, discounts and accrued interest	**(9.6)**	(9.7)
	196.4	196.3

The notes are an unsecured obligation of the Bank admitted to trading on the London Stock Exchange. In the event of the winding up of the Bank, the claims of noteholders would be subordinated in right of payment to the claims of depositors and other creditors of the Bank. They carry an annual interest rate of 11% to maturity. Interest is payable quarterly in arrears.

Notes to the Bank financial statements continued

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

31. Other liabilities

In plain English:

This note gives you more detail on other amounts that we owed at the balance sheet date and a breakdown of lease liabilities.

	2014	2013
Amounts falling due within one year:		
ATM creditor	**3.6**	20.1
Amounts owed to subsidiaries of The Co-operative Banking Group Limited	**126.0**	156.5
Other creditors	**23.9**	21.5
Amounts falling due after one year:		
Other creditors	**4.3**	4.8
	157.8	202.9

Further details of the Bank's related party relationship with The Co-operative Banking Group, a subsidiary of The Co-operative Group, are contained in note 38.

Other creditors of the Bank include finance lease obligations as follows:

	Present value of lease payments		Future minimum lease payments	
	2014	2013	2014	2013
Due within one year	**–**	–	**–**	–
Due between one year and five years	**0.1**	0.1	**0.1**	0.1
Due after five years	**1.3**	1.3	**1.6**	1.6
	1.4	1.4	**1.7**	1.7

The future minimum lease payments have been discounted at LIBOR over the term of the lease to give the present value of these payments.

32. Accruals and deferred income

In plain English:

This note breaks down accruals (amounts owed to suppliers etc. at the year end) and deferred income (income received in advance of it being earned) between short term and long term liabilities.

	2014	2013
Other:		
Amounts falling due within one year	**15.9**	53.9
Amounts falling due after one year	**0.1**	0.2
	16.0	54.1

Accruals falling due within one year include £nil (2013: £18.0m) for fees in relation to the LME.

Notes to the Bank financial statements continued

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

33. Provisions for liabilities and charges

In plain English:

This note shows the probable obligations that we had at the end of the period to make future cash payments for a variety of past occurrences.

Our main provisions are for Payment Protection Insurance compensation, conduct and legal issues, separation costs and the expected cost of the Financial Services Compensation Scheme.

The note also shows new provisions made during the period, which appear as expenses in the Bank Income Statement.

	Note	**Property**	**FSCS levies**	**PPI**	**Conduct/ legal**	**Separation**	**Other**	**Total**
2014								
At the beginning of the year (as restated)		**23.1**	**13.3**	**133.8**	**304.6**	**39.4**	**35.5**	**549.7**
Provided/(released) in the year:								
Interest income		**–**	**–**	**–**	**48.0**	**–**	**–**	**48.0**
Operating expense	11	**2.1**	**24.4**	**–**	**4.4**	**94.5**	**(1.3)**	**124.1**
Provision for customer redress		**–**	**–**	**5.0**	**43.8**	**–**	**3.5**	**52.3**
Utilised during the year		**(0.5)**	**(25.0)**	**(65.2)**	**(38.3)**	**(21.6)**	**(21.5)**	**(172.1)**
Transfer to liabilities associated with non-current assets held for sale		**(0.3)**	**–**	**–**	**–**	**–**	**–**	**(0.3)**
Increase in discount on loans identified for disposal		**–**	**–**	**–**	**–**	**–**	**15.8**	**15.8**
At the end of the year		**24.4**	**12.7**	**73.6**	**362.5**	**112.3**	**32.0**	**617.5**
Provisions were analysed as follows:								
Amounts falling due within one year		**12.6**	**12.7**	**60.0**	**349.9**	**89.5**	**31.6**	**556.3**
Amounts falling due after one year		**11.8**	**–**	**13.6**	**12.6**	**22.8**	**0.4**	**61.2**
		24.4	**12.7**	**73.6**	**362.5**	**112.3**	**32.0**	**617.5**

	Note	Property	FSCS levies	PPI	Conduct/ legal	Separation	Other	Total
2013								
At the beginning of the year (as restated)		7.3	13.8	116.0	0.2	–	0.6	137.9
Provided/(released) in the year:								
Interest income		–	–	–	104.5	–	–	104.5
Operating expense (as restated)	11	16.3	24.1	–	–	39.4	35.0	114.8
Provision for customer redress		–	–	103.0	204.0	–	–	307.0
Utilised during the year		(0.5)	(24.6)	(85.2)	(4.1)	–	(0.1)	(114.5)
At the end of the year (as restated)		23.1	13.3	133.8	304.6	39.4	35.5	549.7
Provisions were analysed as follows:								
Amounts falling due within one year		10.2	13.3	113.8	304.6	39.4	35.5	516.8
Amounts falling due after one year		12.9	–	20.0	–	–	–	32.9
		23.1	13.3	133.8	304.6	39.4	35.5	549.7

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

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

All amounts are stated in £m unless otherwise indicated

33. Provisions for liabilities and charges continued

Property

The Bank has a number of leasehold properties available for rent. Provisions are made when either the sub-lease income does not cover the rental expense or the property is vacant. The provision is based on the expected outflows during the remaining periods of the leases. In addition, dilapidation provisions are recorded to the extent that the Bank has incurred dilapidations and/or the dilapidation clause within the contract has been invoked. During the year £2.7m (2013: £11.5m) has been provided for this.

Financial Services Compensation Scheme (FSCS) levies

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

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

By virtue of it holding deposits protected under the FSCS scheme the Bank has an obligation to pay levies in respect of the interest cost for 2014/15. From 2013, the FSCS had also started to repay the principal of the Treasury loans and a further levy has been raised in 2013/14 and 2014/15 for the expected capital shortfall for these loans, so that they are fully repaid by March 2016. The total levy to be raised is £1,019.0m over three years, with the first instalment of £363.0m collected in 2013 and the second instalment of £399.0m collected in 2014. The Bank has provided £12.7m as at 31 December 2014 (2013 restated: £13.3m) for its share of the levies raised by the FSCS. The Bank's interest levy provision calculation includes estimates of the total FSCS levy in each levy year and estimates of the Bank's market participation in each levy year. The Bank has also paid £14.2m and £10.8m in respect of its 2013/14 interest levy and share of the capital levy respectively in 2014.

Payment Protection Insurance (PPI)

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

The FSA issued a policy statement in August 2010, which amended the 'Disputes Resolution: Complaints' section of the FSA Handbook, setting out new rules for handling complaints, including complaints of PPI mis-selling. The Bank must comply with the policy statement which requires complainants to receive adequate redress and the Bank to deliver fair outcomes and treat customers fairly including non-complainants. An additional provision of £5.0m (2013: £103.0m) has been recognised in the year, in respect of the total expected cost to the Bank of carrying out this work and paying compensation, making total provisions raised of £352.0m (2013: £347.0m). This is discussed in more detail in note 2.

Refer to the Income Statement on p148 for details relating to the change in presentation of provision amounts in relation to net interest income, net fee and commission income and operating expenses.

Conduct/legal provisions

During the year the Bank provided an additional £48.0m (2013: £104.5m) in respect of customer redress due to breaches of the technical requirements of the Consumer Credit Act.

The £43.8m (2013: £204.0m) charged through potential customer redress consists of £37.0m in relation to arrears fees and charges and mortgage delivery costs, a £7.3m release in relation to mortgage fees, a £6.0m release in relation to mortgage documentation and a £20.1m increase of other conduct related provisions.

£4.4m has been provided through operating expenses in relation to other conduct and legal related provisions.

Refer to the Income Statement on p148 for details relating to the change in presentation of provision amounts in relation to net interest income, net fee and commission income and operating expenses.

Other

The net £93.2m (2013: £74.4m) charged through operating expenses consists of £94.5m in relation to costs associated with the separation of the Bank from The Co-operative Group and a £1.3m release relating to other provisions.

During December 2014 the Bank entered into a Sale and Purchase Agreement to dispose of a portfolio of performing loans and associated hedging derivatives not considered to be core assets to a third party. These assets will be derecognised in 2015 after the completion of the contract. A constructive obligation in respect of the discount on the loans identified for disposal of £15.8m has been recognised in 2014 (2013: £nil).

Notes to the Bank financial statements continued
For the year ended 31 December 2014
All amounts are stated in £m unless otherwise indicated

34. Deferred tax

In plain English:

This note describes the tax that the Bank may have to pay in future. Deferred tax arises from differences in the way that tax is calculated for accounts purposes and tax purposes.

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

The movements on the deferred tax accounts are as follows:

		2014			2013 (restated)		
	Note	**Deferred tax asset**	**Deferred tax liability**	**Total**	Deferred tax asset	Deferred tax liability	Total
Deferred tax at the beginning of the year		**25.1**	**(103.0)**	**(77.9)**	162.5	(121.4)	41.1
Credited/(charged) to the income statement:							
Current year		**5.5**	**19.0**	**24.5**	(15.6)	28.9	13.3
Write off of prior year deferred tax asset	13	**–**	**–**	**–**	(137.7)	(10.5)	(148.2)
Prior year		**–**	**–**	**–**	3.3	–	3.3
		5.5	**19.0**	**24.5**	(150.0)	18.4	(131.6)
Credited/(charged) to other comprehensive income:							
Cash flow hedges		**(8.7)**	**–**	**(8.7)**	12.5	–	12.5
Available for sale		**–**	**–**	**–**	0.1	–	0.1
		(8.7)	**–**	**(8.7)**	12.6	–	12.6
Reclassified to assets held for sale		**(0.9)**	**–**	**(0.9)**	–	–	–
Deferred tax at the end of the year		**21.0**	**(84.0)**	**(63.0)**	25.1	(103.0)	(77.9)

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

	2014		2013 (restated)	
	Deferred tax asset	**Deferred tax liability**	Deferred tax asset	Deferred tax liability
Deferred tax comprises:				
Capital allowances on fixed assets and assets leased to customers	**12.1**	**–**	7.4	–
Fair value adjustments – The Co-operative Bank subsidiaries	**–**	**(76.4)**	–	(92.9)
Other temporary differences	**21.0**	**(7.6)**	25.1	(10.1)
Cash flow hedges	**(11.5)**	**–**	(1.6)	–
Unrealised appreciation on investments	**(0.6)**	**–**	(0.6)	–
FSCS levy provision	**–**	**–**	(5.2)	–
	21.0	**(84.0)**	25.1	(103.0)

Deferred tax has been restated as described in note 3.

Net deferred tax assets expected to be recoverable after one year are £21.0m (2013: £25.1m restated).

Other temporary differences for the Bank totalling £13.4m (2013: £15.0m restated) relate to temporary differences arising on consolidation adjustments where the recoverability is not dependent on the future performance of the Bank, and temporary differences in subsidiaries that are forecast to make future taxable profits.

The deferred tax liability of £76.4m (2013: £92.9m restated) relating to fair value adjustments is net of a deferred tax asset of £3.3m (2013: £9.2m restated).

The Directors consider the recoverability of deferred tax to be a critical accounting judgement as detailed in note 2. Detail on the restatement of comparatives is provided in note 3.

Notes to the Bank financial statements continued

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

34. Deferred tax continued

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

	2014	Restated 2013
Capital allowances on fixed assets and assets leased to customers	**(5.1)**	23.9
Fair value adjustments	**(16.5)**	37.1
Other temporary differences	**1.1**	11.1
Cash flow hedges	**1.2**	(1.4)
FSCS levy provision	**(5.2)**	5.2
Tax losses carried forward	**–**	54.8
Pensions and other post-retirement benefits	**–**	0.9
	(24.5)	131.6

Deferred tax assets totalling £297.5m (2013: £256.9m restated) have not been recognised where doubt exists over the availability of sufficient future taxable profits. Deferred tax has not been recognised in respect of trading losses of £1,229.2m (with deferred tax of £245.8m), capital losses of £16.4m (with deferred tax of £3.3m), and other temporary differences of £242.0m (with deferred tax of £48.4m). Deferred tax assets from the prior year of £nil (2013: £148.1m restated) have been written off in the period. Deferred tax assets of £22.7m (2013: £115.9m restated) in respect of the current year have not been recognised.

Reductions in the UK corporation tax rate from 23% to 21% (effective from 1 April 2014) and 20% (effective from 1 April 2015) were substantively enacted on 2 July 2013. This will reduce the Bank's future current tax charge accordingly. Deferred tax as at 31 December 2014 has been calculated based on the rate of 20% substantively enacted at the balance sheet date.

On 3 December 2014 the Chancellor of the Exchequer announced that the UK Government will introduce legislation in the Finance Bill 2015, which will restrict the proportion of banks' annual taxable profit that can be offset by certain carried forward tax losses. The restriction will take effect from 1 April 2015 and will apply to relevant tax losses arising prior to this date.

The Chancellor's announcements had not been enacted or substantively enacted at the balance sheet date and as the Bank has not recognised a deferred tax asset on carried forward tax losses there would be no impact on the tax balances in the financial statements for the year ended 31 December 2014. We will consider the impact of the final legislation once enacted.

35. Pensions

In plain English:

The Co-operative Group Pension Scheme (Pace) is the main pension scheme of The Co-operative Group and in which the Bank continues to participate. Pace is a hybrid scheme, consisting of a defined benefit section and a defined contribution section. In August 2014 the Bank agreed to contribute £5m representing 20% of the scheme's funding deficit for one year.

Ordinarily, defined benefit schemes appear as an asset (when in surplus) or as a liability (when in deficit) on the balance sheet. However, because there is no consistent reliable basis for identifying the Bank's share of the assets and liabilities we report the scheme as though it were a defined contribution scheme (money purchase). As a result, the pension scheme does not appear on the balance sheet. Instead for Pace, we just show the pension contributions as an expense in the income statement.

In the past the Bank has not included the Britannia Pension scheme on its balance sheet for the same reasons as outlined for Pace. Following further operational separation from The Co-operative Group in 2014, the Bank has been able to recognise this pension scheme on the Bank's balance sheet.

This note gives you detailed information on the Pace and Britannia scheme assets, liabilities and all the assumptions we have made in reaching these values. In addition it provides details of the Bank's small unfunded scheme.

Pension charge

The pension charge in the income statement at 31 December 2014 was £31.0m (2013: £29.3m) which includes £2.1m (2013: £8.0m) as the Bank's contribution to the Pace deficit recovery charge. Of this, £nil (2013: £0.6m) is included in operating costs incurred outside the normal course of business.

Notes to the Bank financial statements continued

For the year ended 31 December 2014

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35. Pensions continued

The Co-operative Pension Scheme (Pace)

The Bank participates in Pace, a hybrid scheme, consisting of a defined benefit section and a defined contribution section.

At 31 December 2012 the scheme was recognised as a Group plan, since risks were shared between entities under the common control of The Co-operative Group. It was accounted for on a defined contribution basis since there was no contractual agreement or stated Co-operative Group policy for charging the net defined benefit cost for the scheme as a whole to individual participating entities. Therefore, the Bank did not recognise its share of the net defined benefit cost. The net defined benefit cost of the pension scheme was recognised fully by the sponsoring employer, which was The Co-operative Group Limited.

On 4 November 2013, The Co-operative Group and the Bank entered into an undertaking pursuant to which The Co-operative Group agreed with the Bank, subject to certain exceptions, not to require the Bank to cease to participate in Pace in connection with the LME or any subsequent reduction in The Co-operative Group's shareholding in the Bank (including to nil). During 2015, The Co-operative Group and the Bank are expected to conclude discussions to agree on the separation of Pace, so that the scheme liability properly attributable to the Bank and an equivalent proportion of the scheme's assets would be transferred to a separate tax registered pension scheme, or a segregated section of Pace. Separation of Pace will require the agreement of the Pace Trustees.

Following separation of the Bank from the wider Co-operative Group as a result of the LME, the Bank remains a participating employer in the Pace scheme and the Pace scheme is considered to be a multi-employer scheme under IAS 19 Employee benefits (revised 2011).

As a multi-employer pension scheme, Pace exposes the participating businesses to actuarial risks associated with the current and former employees of the other participating employers. The proportion of Pace liabilities accrued by members whilst employees of the Bank is believed to represent a minority of total Pace liabilities. The Bank could, however, be liable for funding a greater proportion of Pace liabilities.

There are for example liabilities in Pace relating to benefits accrued by members whilst employed by CFSMS and working in the Bank's business. On 23 January 2014, following the legal separation of the Bank from the wider Co-operative Group, employment contracts for the majority of those employees who spend most of their time working on behalf of the Bank were transferred from CFSMS to the Bank. This has increased the number of Bank employees participating in the Pace scheme in 2014.

There may also be 'orphan liabilities' in Pace that do not relate to any current employer participating in Pace. The extent to which the Bank could be liable for funding a greater proportion of Pace liabilities will depend, inter alia, on what position is reached as to the Pace liabilities properly attributable to the Bank following discussions with The Co-operative Group and the Pace Trustee. Such discussions are not yet substantively underway.

There is therefore currently insufficient information available to consistently and reliably identify the Bank's share of Pace liabilities and employer costs. For the above reasons the pension costs in respect of Pace are accounted for on a defined contribution basis in accordance with IAS 19 (revised 2011). Pension costs are recognised as an expense in the Bank income statement on a defined contribution basis as explained below, based on a fixed percentage as agreed with the Trustee.

The Pace scheme is not sectionalised and operates on a 'last man standing' basis. In the event that other participating employers become insolvent and the full statutory debt is not recovered on insolvency, the Bank would become liable for the remaining liabilities.

There is no agreed allocation of a deficit or surplus on (i) wind up of the plan; or (ii) the entity's withdrawal from the plan.

The key aspects of Pace are illustrated below.

Scheme information

Risks arising in Pace are identified at The Co-operative Group level, with the impact of any changes to contribution assessed under the Bank's risk management framework. The Bank is therefore exposed to potential future increases in required contributions and capital held for pension risk. The Pace Trustee, in consultation with The Co-operative Group, is responsible for the risk management arrangements for Pace agreeing suitable contribution rates, investment strategy and for taking appropriate professional advice as required.

Contribution payments

On an accounting basis the Pace scheme is in a surplus of £1,128.5m at 31 December 2014 (2013: surplus of £355.9m). Under the current arrangements the Bank does not have an unconditional right of refund of scheme assets on winding up or any right to reduction of contributions as a result of this surplus.

Based on advice from a qualified actuary, the contributions in respect of future service in the defined benefit section are currently 18%.

Notes to the Bank financial statements continued

For the year ended 31 December 2014

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35. Pensions continued

The Pace triennial valuation as at 5 April 2013 was completed on 21 July 2014. The funding shortfall for the entire scheme had increased from £248.0m per the previous triennial valuation as at 5 April 2010 to £600.0m as at 5 April 2013. The latest funding shortfall position calculated by the scheme actuary on an approximate basis as at 31 May 2014 was £104.0m. The level of funding for the Pace scheme is agreed between The Co-operative Group and the Pace Trustee. The Co-operative Group agreed a recovery plan with the Trustee of the scheme to contribute £25m per annum over 5 years from 1 July 2014 to 30 June 2019 (inclusive) to repay the £104.0m deficit calculated on an approximate basis as at 31 May 2014. On 19 August 2014, the Bank agreed to meet 20% of the total Pace deficit contributions at that date for a period of one year only. The Bank recognised £5m on 19 August 2014 as a result of this agreement which represented 12 months of deficit contribution being the time frame which was expected to elapse to the point that the Pace separation process is completed. The liability in respect of the deficit contribution agreement dated 19 August 2014 as at 31 December 2014 was £2.9m (2013: £nil). The current recovery plan ending in 2019 between The Co-operative Group and the Pace scheme Trustees may however be insufficient to repay the latest valuation of the deficit. The Bank's agreement on 19 August 2014 to meet 20% of the total Pace deficit contributions was predicated upon this percentage contribution not setting a precedent for future discussions on the separation of accrued Pace assets and liabilities between The Co-operative Group and the Bank. The Co-operative Group has undertaken to agree with the Bank its final proportion of employer contributions in Pace and, if not agreed, the matter will be referred to an independent third party. Accordingly, there is a wide range of outcomes regarding the duration and contribution requirements of a new schedule of contributions and recovery plan which make the overall contributions uncertain.

The next formal triennial valuation of Pace as at 5 April 2016 will not be completed until 2017, however a funding shortfall position calculated by the scheme actuary on an approximate basis is expected in 2015. There is therefore a risk that in future periods the Bank will recognise significant liabilities in respect of the scheme in its accounts.

The Bank also pays contributions in respect of the employed members of the defined contribution sections of the scheme of either 2% or 8% of pensionable salaries. The key financial aspects of Pace are illustrated below for information. These amounts are not recognised within these financial statements.

Key assumptions of the Pace pension scheme

The key aspects of the Pace scheme are as follows:

	2014	2013
The principal assumptions used to determine the liabilities of the Pace scheme are:		
Discount rate	**3.70%**	4.45%
Rate of increase in salaries	**3.30%**	3.60%
Future pension increases where capped at 5.0% per annum	**3.30%**	3.60%
Future pension increases where capped at 2.5% per annum	**2.50%**	2.50%
Assumptions used to determine net pension cost for the Pace scheme are:		
Discount rate	**4.45%**	4.60%
Rate of increase in salaries	**3.60%**	4.80%

The average life expectancy (in years) for mortality tables used to determine scheme liabilities for the Pace scheme at 31 December 2014 is:

	Male	**Female**
Life expectancy:		
Member currently aged 65 (current life expectancy)	**22.8**	**24.9**
Member currently aged 45 (life expectancy at age 65)	**25.0**	**27.2**

The balance sheet amounts attributable to the entire scheme are as follows:

	2014	2013
Fair value of plan assets	**9,153.7**	7,486.5
Present value of funded obligations	**(8,024.8)**	(7,125.8)
	1,128.9	360.7
Present value of unfunded obligations	**(0.4)**	(4.8)
	1,128.5	355.9

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35. Pensions continued

The asset allocations at the year end were as follows:

	2014	2013
Equities	**1,808.1**	2,398.8
Liability driven investments	**5,228.7**	3,382.6
Alternative growth	**964.8**	994.2
Property	**318.6**	308.6
Other	**833.5**	402.3

The table below shows the fair value of the assets in each category which have a quoted market price:

	2014	2013
Equities	**1,808.1**	2,395.8
Liability driven investments	**4,912.7**	2,654.9
Other	**378.9**	338.2

Britannia Pension Scheme (Britannia Scheme)

The Britannia Scheme is a hybrid scheme, consisting of a defined benefit section and a defined contribution section.

In 2009, following the transfer of engagements of Britannia Building Society, CFSMS, a Co-operative Group subsidiary, became principal employer of the scheme. Three other participating employers of the Britannia Scheme are Bank wholly owned subsidiary entities. The Bank itself is not a participating employer in the scheme, but provides a guarantee to the Britannia Trustee in relation to funding the pension obligations.

The scheme closed on 6 October 2010 with active members at the date of closure being invited to join the Co-operative Pension Scheme (Pace) for future pension accrual. No future service contributions are payable to the scheme due to the closure of the scheme to future accrual. The Trustee agreed to wind up the defined contribution section from February 2013, with any remaining members given the option of transferring their funds to an alternative approved pension arrangement, or secured benefits with an insurance contract. The weighted average duration of the defined benefit obligation of the Britannia Scheme is 23 years.

At 31 December 2012 the scheme was recognised as a Group plan since all participating entities were within common control of The Co-operative Group. The Bank and its subsidiary entities participating in the scheme (Platform, WMS and Britannia International) accounted for the scheme on a defined contribution basis, recognising the contribution paid as an expense in the income statement. Following separation of the Bank from the wider Co-operative Group as a result of the LME in 2013, the scheme was considered to be a multi-employer scheme under IAS 19 (revised 2011). At 31 December 2013 the Bank did not have sufficient information to reliably and consistently measure its share of the obligation and therefore the Bank accounted for the scheme on a defined contribution basis. During 2014, employment contracts for those employees who spent the majority of their time working on behalf of the Bank were transferred from CFSMS to the Bank. As a result of this transfer, whilst CFSMS remains the sponsoring employer of the scheme, the Bank has recognised the total assets and liabilities of the scheme on the balance sheet as at 31 December 2014.

Whilst the Britannia Scheme is in an accounting surplus, this has not been recognised on the balance sheet in accordance with IFRIC 14. The Bank has however recognised a £3.3m liability (2013: unrecognised £3.1m) representing unfunded pension liabilities of the Britannia Supplementary Pension and Life Assurance Plan. There is no charge supplementary arrangement for certain Executive Directors. Benefits under this unfunded arrangement are valued on the same assumptions as the Britannia Scheme and are disclosed as unfunded obligations.

Nature of benefits

The Britannia Scheme pays out pensions at retirement based on service to 6 October 2012 and final pay for employees who commenced employment prior to 1 September 2001, when it closed to new members.

Funding the liabilities

Britannia Pension Trustees Limited is the corporate body that acts as 'Trustee' of the Britannia Scheme. UK legislation requires the Trustee to carry out valuations at least every three years and to target full funding against a basis that prudently reflects the scheme's risk exposure. The Scheme Actuary completed an actuarial valuation of the Scheme as at 5 April 2011, in accordance with the scheme specific funding requirements of the Pensions Act 2004. The results of the valuation showed that the Britannia Scheme had a shortfall of £3.7m. CFSMS (the sponsoring employer) agreed to pay a lump sum of £3.7m to eliminate this shortfall. The latest funding shortfall position calculated by the scheme actuary as at 5 April 2013 was £61.3m. The statutory deadline for the 5 April 2014 Britannia Scheme triennial valuation is 5 July 2015.

As at 31 December 2014 the Bank has no requirement to pay deficit contributions in respect of the Britannia Scheme.

Notes to the Bank financial statements continued

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

35. Pensions continued

Governance

The Chair of the Trustee Board is appointed by and from the Trustee Directors and the Board comprises an Independent Trustee, nominees of The Co-operative Group and elected scheme Members. The Trustee, in consultation with CFSMS and the Bank, is responsible for the risk management arrangements for the Britannia Scheme, agreeing suitable contribution rates, investment strategy and for taking professional advice as appropriate.

Risks associated with the Scheme

Risks arising in the Britannia Scheme are identified and assessed under the Bank's Risk Management Framework. The Bank is exposed to potential future increases in required contributions and capital held for pension risk.

Actions taken by the Pensions Regulator, changes to European legislation, or changes in the financial strength of CFSMS or the Bank could result in stronger funding standards, which could materially affect the Bank's cash flow and balance sheet. There is also a risk that changes in the assumptions for life expectancy, interest rates or in price inflation could result in a deficit in the scheme. Other assumptions used to value the defined benefit obligation are also uncertain, although their effect is less material.

The Bank has also granted a guarantee in respect of participating employers' liabilities in relation to the Britannia Scheme up to 105% funding on the section 179 Pensions Act 2004 valuation basis.

Investment strategy

Some risk arises from the Britannia Scheme defined benefit section because the value of the asset portfolio and returns from it may be less than expected. There is also a risk of a mismatch between the Scheme's assets and liabilities and differences in sensitivity to changes in financial and demographic factors. The Trustee's objective is to invest the Scheme's assets in the best interest of the Members and beneficiaries. Within this framework the Trustee has agreed a number of objectives to help guide them in their strategic management of the assets and control of the various risks to which the Britannia Scheme is exposed.

Indirect participation

In 2014 the Bank paid approximately £1m (2013: £1m) to CFSMS in relation to Britannia Scheme pension costs. The pension cost shown in these accounts is the actual contribution paid by the Bank and three of its subsidiaries.

As explained above, on 23 January 2014, following the legal separation of the Bank from the wider Co-operative Group, employment contracts for the majority of those employees who spend the most of their time working on behalf of the Bank were transferred from CFSMS to the Bank.

Critical accounting estimates and judgements – sensitivity of defined benefit obligations

The measurement of the Bank'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 Bank 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 Bank, taking into account the duration of the liabilities. An increase or decrease in the discount rate of 0.1% would result in a £15.7m decrease or a £15.7m increase, respectively, 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. The assumption adopted is consistent with the discount rate adopted. An increase or decrease in the inflation rate of 0.1% would result in a £15.8m increase or a £15.8m decrease, respectively, 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. An increase in the assumed long term rate of improvement in mortality from 1.5% per annum to 1.75% per annum would increase the present value of the defined benefit obligation by £12.2m.

Notes to the Bank financial statements continued

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

35. Pensions continued

The key aspects of the defined benefit section of the Britannia Scheme are disclosed in the following tables. The Britannia Scheme was not recognised as at 31 December 2013 (as explained above), however comparative information has been provided for illustrative purposes.

	2014	2013
The principal assumptions used to determine the liabilities of the Britannia defined benefit scheme are:		
Discount rate	**3.70%**	4.45%
Rate of increase in salaries	**3.20%**	3.60%
Future pension increases where capped at 5.0% per annum	**3.15%**	3.60%
Future pension increases where capped at 2.5% per annum	**2.20%**	2.50%
Assumptions used to determine net pension cost for the Britannia defined benefit scheme are:		
Discount rate	**4.45%**	4.60%
Rate of increase in salaries	**3.60%**	4.80%

The average life expectancy (in years) for mortality tables used to determine defined benefit scheme liabilities for the former Britannia Building Society Scheme as at 31 December 2014 is:

	Male	Female
Life expectancy:		
Member currently aged 65 (current life expectancy)	**22.9**	**25.1**
Member currently aged 45 (life expectancy at age 65)	**25.2**	**27.5**

The amounts recognised in the balance sheet of the Bank are as follows:

	2014	2013
Fair value of plan assets	**728.5**	630.7
Present value of funded obligations	**(683.7)**	(604.2)
	44.8	26.5
Pension surplus not recognised under IAS 19 (revised 2011)	**(44.8)**	(26.5)
Present value of unfunded obligations	**(3.3)**	(3.1)
	(3.3)	(3.1)

The amounts recognised in the income statement of the Bank are as follows:

	2014	2013
Interest expense on defined benefit obligation	**(26.5)**	(26.6)
Interest income on plan assets	**27.7**	27.4
Interest expense on effect of onerous liability	**(1.2)**	(0.7)
Total net interest cost	**–**	0.1
Administrative expenses	**(1.5)**	(1.1)
Defined benefit cost included in income statement	**(1.5)**	(1.0)

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

	2014	2013
Defined benefit obligation at the start of the year	**604.2**	586.8
Interest expense	**26.5**	26.6
Benefit payments from plan assets	**(15.8)**	(16.2)
Remeasurements:		
Effect of changes in demographic assumptions	**12.0**	–
Effect of changes in financial assumptions	**56.8**	7.0
Defined benefit obligation at the end of the year	**683.7**	604.2

Notes to the Bank financial statements continued
For the year ended 31 December 2014
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35. Pensions continued
Changes in the fair value of the plan assets are as follows:

	2014	2013
Fair value of plan assets at the start of the year	**630.7**	602.7
Interest income	**27.7**	27.4
Benefit payments from plan assets	**(15.8)**	(16.2)
Administrative expenses paid from plan assets	**(1.5)**	(1.1)
Return on plan assets (excluding interest income)	**87.4**	17.9
Fair value of plan assets at the end of the year	**728.5**	630.7

Changes in the effect of the asset ceiling are as follows:

	2014			2013		
	Asset	Defined benefit obligation	Asset ceiling	Asset	Defined benefit obligation	Asset ceiling
At the start of the year	**630.7**	**(604.2)**	**(26.5)**	602.7	(586.8)	(15.9)
Interest income/(expense)	**27.7**	**(26.5)**	**(1.2)**	27.4	(26.6)	(0.8)
Administrative expenses paid from plan assets	**(1.5)**	**–**	**1.5**	(1.1)	–	1.1
Benefits paid	**(15.8)**	**15.8**	**–**	(16.2)	16.2	–
Actuarial gains/(losses)	**87.4**	**(68.8)**	**(18.6)**	17.9	(7.0)	(10.9)
Fair value of plan assets at the end of the year	**728.5**	**(683.7)**	**(44.8)**	630.7	(604.2)	(26.5)

The asset allocations at the year end were as follows:

	2014	2013
Equities	**118.5**	153.4
Liability driven investments	**463.0**	286.4
Alternative growth	**49.1**	100.6
Property	**87.3**	89.6
Other	**10.6**	0.7

The table below shows the fair value of the assets in each category which have a quoted market price:

	2014	2013
Equities	**118.5**	153.4
Liability driven investments	**425.7**	286.4
Other	**9.3**	0.1

Bank (unfunded) pension scheme
The Bank also operates a small unfunded pension scheme.

	2014	2013	2012	2011	2010
Rate of increase of pensions in payment	**3.3%**	3.6%	3.3%	3.3%	3.7%
Rate of increase in salaries	**3.3%**	5.1%	4.8%	4.8%	5.2%
Discount rate	**3.7%**	4.7%	4.6%	4.6%	5.2%

The assumptions used by the actuary were the best estimates chosen from a range of possible actuarial assumptions which, due to the timescales covered, may not necessarily be borne out in practice.

Notes to the Bank financial statements continued

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

35. Pensions continued

The values of the assets and liabilities of the unfunded pension scheme were:

	2014	2013
Present value of unfunded obligations	**(4.7)**	(4.0)
Deficit in scheme	**(4.7)**	(4.0)
Related deferred tax asset	**0.9**	0.9
Net pension liability	**(3.8)**	(3.1)
Analysis of amount charged to income statement:		
Current service cost	**–**	–
Interest on pension scheme liabilities	**0.2**	0.2
	0.2	0.2

Changes in the present value of the scheme liabilities are as follows:

	2014	2013
Opening defined benefit liabilities	**4.0**	4.0
Current service cost	**–**	–
Interest on liabilities	**0.2**	0.2
Actuarial losses	**0.7**	–
Benefits paid	**(0.2)**	(0.2)
Closing defined benefit liabilities	**4.7**	4.0

Amounts recognised in the statement of comprehensive income:

	2014	2013
Actuarial losses on scheme liabilities during the period	**0.7**	–
Total scheme losses during the period	**0.7**	–

The amounts for the current year are as follows:

	2014	2013
Defined benefit obligation	**(4.7)**	(4.0)
Deficit in scheme	**(4.7)**	(4.0)
Experience adjustment on scheme liabilities	**–**	–
Experience adjustment on scheme assets	**–**	–

Notes to the Bank financial statements continued

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

36. Contingent liabilities

In plain English:

Contingent liabilities are possible obligations whose existence will be confirmed only by uncertain future events or present obligations where the transfer of economic resources is uncertain and cannot reasonably be measured. Contingent liabilities are not recognised on the balance sheet but are disclosed if the outflow of resources is remote.

The tables below provide the contract amounts and risk weighted amounts of contingent liabilities and commitments. The contract 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 PRA 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.

	Unaudited		Unaudited	
	Contract amount 2014	**Risk weighted amount 2014**	Contract amount 2013	Risk weighted amount 2013
Contingent liabilities:				
Guarantees and irrevocable letters of credit	**43.2**	**18.0**	86.4	45.4
Other commitments:				
Documentary credits and short term trade related transactions	**–**	**–**	0.8	0.2
Forward asset purchases and forward deposits placed[1]	**154.9**	**77.8**	570.1	152.1
Undrawn formal standby facilities, credit lines and other commitments to lend (includes revocable and irrevocable commitments)[2]	**2,862.9**	**448.5**	3,432.8	684.3
	3,061.0	**544.3**	4,090.1	882.0

1. Forward asset purchases have significantly reduced during the year due to repos maturing and there being lower funding requirements.
2. Undrawn loan commitments include revocable commitments which are unused credit card limits of £1,787.3m (2013: £1,968.1m).

Assets pledged

Assets are pledged as collateral under repurchase agreements with other banks. These deposits are not available to finance the Bank's day-to-day operations. Mandatory reserve deposits are also held with the Bank of England in accordance with statutory requirement.

See note 40.d for further details of assets pledged.

Notes to the Bank financial statements continued

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

36. Contingent liabilities continued

Commitments under operating leases

The Bank leases various properties and equipment 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 Co-operative Bank plc remains in negotiations to enter into leases for the CIS Building in Manchester and these are expected to be finalised in 2015. The table below discloses the minimum operating lease payments the Bank will be required to make over the remaining lives of the leases.

	Land and buildings 2014	**Equipment 2014**	Land and buildings 2013	Equipment 2013
Falling due:				
Within one year	**18.3**	**0.1**	18.7	–
Between one and five years	**46.3**	**0.3**	50.7	0.4
In five years or more	**51.5**	**–**	70.0	–
	116.1	**0.4**	139.4	0.4

The Bank leases a number of branch and office premises 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 for the Bank was £5.0m (2013: £8.0m).

Indemnification agreement

The Bank has an indemnification agreement with CFSMS, accounted for as a guarantee under IFRS 4, in which the Bank has agreed to indemnify CFSMS against all and any liability, loss, damage, costs and expense arising from the agreement (under which CFSMS provides certain assets and services to the Bank). This agreement will remain in place until it is terminated after separation activities with the wider Co-operative Group are fully completed, but this will require the consent of CFSMS.

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 risk that certain aspects of the Bank's 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 is a risk that there may be other regulatory investigations and action against the Bank in relation to conduct and other issues that the Bank 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 nature of any future disputes and legal, regulatory or other investigations or proceedings into such matters cannot be predicted in advance. Furthermore, the outcome of any ongoing disputes and legal, regulatory or other investigations or proceedings is difficult to predict.

Consumer Credit Act issues

The Consumer Credit Act regulates consumer lending and governs the way in which entities, including banks, providing consumer credit to retail customers carry out business. From 1 April 2014 the Financial Services and Markets Act 2000 also applies alongside certain retained provisions of the Consumer Credit Act. The Consumer Credit Act includes very detailed, prescriptive and highly technical requirements for lenders affecting customer documentation and which, in turn, impact how operational processes and IT systems are configured. While the Bank has undertaken a detailed analysis to identify certain instances where its documentation or processes have not been fully compliant with the technical requirements and has provided accordingly, it is not possible to rule out the possibility of other instances which have not yet been identified. Breaches may have the effect of triggering periods of non-compliance during which an affected customer is not liable to pay interest.

Debit interest refunds would therefore need to be made in certain cases where a period of non-compliance has been previously triggered, in the same way the Bank will be making such refunds as a consequence of the issues already identified (and provided for).

During the year the Bank provided £65.0m (2013: £109.5m) for identified issues. As part of the process of identification, detailed and technical legal analysis has been carried out as to whether breaches of the technical requirements have in fact occurred. Such legal analysis by its nature involves judgement and assessment of the facts of particular circumstances. In the event that such legal analysis and judgements are determined to be wrong, the Bank could be exposed to a material additional liability. The amount of £174.5m which has been provided is the best estimate of the liability based on the legal analysis.

Notes to the Bank financial statements continued

For the year ended 31 December 2014

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36. Contingent liabilities continued

Regulatory and other investigations

The Bank is the subject of multiple regulatory and other investigations and enquiries into events at the Bank and circumstances surrounding them. These include:

- The Treasury announced by press release on 22 November 2013 that it intends to conduct an independent investigation into events at the Bank and the circumstances surrounding them from 2008, including the Verde transaction and Britannia merger. The investigation will review the conduct of Regulators and the Government but is not anticipated to commence until it is clear that it will not prejudice the outcome of the Financial Conduct Authority (FCA) and Prudential Regulation Authority (PRA) enforcement investigations.
- The PRA is undertaking an enforcement investigation in relation to the Bank and as part of that investigation will consider the role of former senior managers.
- The FCA is undertaking enforcement investigations into events and decisions at the Bank up to June 2013.
- The Financial Reporting Council 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.
- The Bank is co-operating with the investigating authorities. It is not possible to estimate the financial impact upon the Bank should any adverse findings be made.

Legal proceedings

The Bank is engaged in various other legal proceedings in the UK involving claims by and against it which arise in the ordinary course of business, including debt collection, mortgage enforcement, consumer claims and contractual disputes. The Bank does not expect the ultimate resolution of any of these proceedings to which the Bank is party to have a material adverse effect on its results of operations, cash flows or the financial position of the Bank and has not disclosed the contingent liabilities associated with these claims. Provisions have been recognised for those cases where the Bank is able reliably to estimate the probable loss where the probable loss is not de minimis. See note 33.

Mortgage securitisation representations and warranties

In connection with the Bank's mortgage securitisations and covered bond transactions described in note 29 (Bank financial statements) and note 23 (Company financial statements), the Bank makes various representations and warranties relating to the mortgage loans, including in relation to ownership, compliance with legislation and origination procedures. If the representations and warranties are breached subject to any applicable materiality determination, the Bank may be required to repurchase the affected mortgage loans or in some circumstances pay compensation to the securitisation vehicle.

There is a risk that a number of the underlying matters giving rise to the conduct and legal provisions set out in note 33 could have given rise to breaches of such representations and warranties. Accordingly there is a risk that the Bank may be required to pay compensation or repurchase affected mortgage loans in amounts that may reduce the Bank's liquidity.

The Bank is unable to estimate the extent to which, the matters described above will impact it or how future developments may have a material adverse impact on the Bank's net assets, operating results or cash flows in any particular period.

Pensions

There is uncertainty over the amount that the Bank will have to pay while it continues to participate in Pace. The Bank's obligations to contribute to Pace would increase significantly if another large employer in Pace becomes insolvent while the Bank continues to participate. If the Bank seeks to address these risks by terminating its participation, the default position is that material liabilities in respect of the deficit in Pace will arise. The Co-operative Group and the Bank have entered good faith discussions to manage this by reaching agreement so that the liabilities properly attributable to the Bank (and an equivalent proportion of assets) would be transferred to a separate scheme, or a segregated section of Pace, on the Bank's exit but, no arrangements have yet been agreed. There is therefore uncertainty over the amount that the Bank will have to pay in the event that it exits Pace. Separation of Pace will also require the co-operation of the Pace Trustees which may not be forthcoming.

The Pace scheme is not sectionalised and operates on a 'last man standing' basis. In the event that other participating employers become insolvent and the full statutory debt is not recovered on insolvency, the Bank would become liable for the remaining liabilities.

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

In respect of the Britannia Scheme, the Bank will need to manage the liabilities that could arise on separation from The Co-operative Group. This will require the co-operation of the Trustees of the Britannia Scheme, which may not be forthcoming. It is not practicable to provide an estimate of the financial impact of these matters or what effect if any that these matters may have upon the Bank's operative revenues, cash flows or financial position in any period.

Notes to the Bank financial statements continued
For the year ended 31 December 2014
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36. Contingent liabilities continued

Former Britannia Building Society pension scheme guarantee

Following the transfer of engagements of Britannia Building Society, in 2009 the Britannia pension scheme transferred to CFSMS. Under the terms of this transfer the Bank entered into a deed of guarantee to provide assurance to the trustees of the pension scheme to support CFSMS in meeting its funding obligations to the scheme should CFSMS be unable to pay its obligations as they fall due. However, The Co-operative Group has undertaken to ensure that, CFSMS will not take or omit to take any action without the Bank's prior agreement if the result would be to increase the Bank's liabilities or contributions in respect of the Britannia Scheme. The most recent actuarial report indicated that the funding deficit in the Britannia Scheme as at 5 April 2013 was £61.0m. The scheme was recognised in 2014 as explained in note 35.

Tax treatment of separation

Until separation of the Bank from The Co-operative Group is complete, the Bank will continue to be responsible for indemnifying CFSMS under the CFSMS-Bank Services Agreement.

During 2013, the Directors reviewed and reconsidered the accounting treatment of the intangible asset in development and all other assets held on the balance sheet of CFSMS which were used solely by the Bank. The Directors concluded that the Bank was substantially exposed to the risks and rewards of these assets and after considering the funding of the asset and CFSMS's lack of assets to absorb losses, the appropriate accounting treatment would be to hold these assets on the balance sheet of the Bank. The Bank applied an approach to the tax and accounting treatment of the Bank exclusive assets. However, if, and that to the extent that, there is a change to this treatment, there may be an additional tax charge. In November 2014 the Bank became the legal owner of the assets held by CFSMS for the provision of services exclusively to the Bank.

There will continue to be VAT charges incurred in respect of any assets that are supplied to the Bank under the CFSMS-Bank Services Agreement that are not owned by the Bank, until separation is fully effected.

37. Investments in joint ventures

In plain English:

This note gives information on the Bank's investment in joint ventures. More information on the Bank's subsidiaries (companies controlled by the Bank) can be found in note 24 to the Company financial statements. In the main, our subsidiaries are a mixture of leasing, property investment and specialist mortgage companies.

The Bank's investment in joint ventures is £5.3m (2013: £4.7m).

The Bank owns 49% of the ordinary shares in Britannia Personal Lending Limited, a company registered in England and operating in the UK. The company trades in the business of unsecured personal lending and is considered a joint venture as decisions about relevant activities require the unanimous consent of the joint ventures.

The Bank's interest in Britannia Personal Lending Limited is as follows:

	2014	2013
Current assets	**7.5**	7.7
Non-current assets	**1.3**	5.1
	8.8	12.8
Current liabilities	**3.5**	4.4
Non-current liabilities	**–**	3.7
Equity	**5.3**	4.7
	8.8	12.8
Income	**0.9**	0.9
Expenses	**(0.3)**	(0.2)
Profit before tax	**0.6**	0.7
Taxation	**–**	–
Profit after tax	**0.6**	0.7

Joint ventures are accounted for using the equity method.

Notes to the Bank financial statements continued

For the year ended 31 December 2014

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38. Related party transactions

In plain English:

We are required to disclose transactions that the Bank has entered into with individuals or companies who have a close relationship with the Bank. The disclosures are designed to help shareholders establish whether those transactions were conducted at arm's length on normal commercial terms.

Parent, subsidiary and ultimate controlling party

The ownership structure of the Bank changed on 20 December 2013 as a result of the LME, after which, The Co-operative Banking Group, a subsidiary of The Co-operative Group, owned approximately 30% of the Bank. The remaining, approximately 70%, was owned by a number of investors, none of which individually owned more than 10% at the end of 2013. As a result of a further share issue of £400m to existing shareholders in May 2014, The Co-operative Banking Group's share dropped to 20.16%.

At 31 December 2014, the Bank is an associate of, and therefore a related party of, The Co-operative Group as The Co-operative Group owns 20.16% of the Bank's ordinary shares, has the right to Bank Board representation and there are material transactions between the two companies.

The Bank has a significant relationship with The Co-operative Group. As part of the Recapitalisation plan and the Bank ceasing to be a wholly owned subsidiary of The Co-operative Group, the Bank entered into the following agreements and several other arrangements.

Transactions with The Co-operative Group

Balances owed by The Co-operative Group to the Bank are shown on page 221. In total these exceed amounts owed by any other single counterparty and would exceed the Bank's risk appetite in the normal course of business. These obligations are currently performing in line with expectations and based on investigations and the information provided, the Board considers that impairment is not required.

Relationship Agreement

In anticipation of the completion of the LME and the Bank ceasing to be a wholly-owned subsidiary of The Co-operative Group, the Bank entered into an agreement with The Co-operative Group and The Co-operative Banking Group on 4 November 2013 (the Relationship Agreement) to regulate the basis of their ongoing relationship. For more information about the Relationship Agreement see the Corporate Governance Report Co-existence.

Principles

The Co-existence Principles govern the use of trademarks containing 'Co-operative' or 'Co-op' and other associated trademarks owned by both parties. For more information about the Co-existence Principles see the Corporate Governance Report – Co-existence Principles and the use of the 'Co-op' brand.

2014 Commitment Agreement

On 4 November 2013, The Co-operative Banking Group entered into the 2014 commitment agreement with the Bank (the 2014 Commitment Agreement), conditional on the successful implementation of the LME, to subscribe for new ordinary shares satisfied by an irrevocable undertaking to pay £333m (the Undertaking to Pay to the Bank). These commitments were satisfied with the final tranche paid by The Co-operative Group in December 2014.

Intra-group Loan

On 4 November 2013, the Bank, The Co-operative Banking Group and the Co-operative Group Limited entered into an intra-group loan facility (the Intra-group Loan) whereby the Co-operative Group Limited made available to The Co-operative Banking Group during 2014 a term loan facility of up to £313m to be utilised by way of advances. The maturity date of the loan facility is 27 July 2019.

The purpose of the Intra-group Loan was to support The Co-operative Banking Group's Undertaking to Pay the Bank the agreed 2014 capital commitment as a result of the LME, which was paid in full by December 2014.

Pensions Undertaking

On 4 November 2013, The Co-operative Group and the Bank entered into an undertaking whereby The Co-operative Group agreed with the Bank not to require the Bank to cease to participate in Pace in connection with the LME. The parties also agreed at the request of one of the parties to enter into good faith discussions to reach agreement on the separation of Pace and agree the Bank's proportion of employer contributions in Pace (and if not agreed, the matter will be referred to an independent third party). Further information is provided in note 35.

IT and other services

The Bank and The Co-operative Group entered into an IT Costs Separation Agreement on 22 January 2015. In consequence of the Bank's IT outsourcing agreement with IBM for enterprise computing services, the Bank is not progressing the proposed revised IT Service Agreement (ITSA) and Professional Services Master Service Agreement (PSMSA) which were described in the 2013 Annual Report and Accounts. A number of service contracts under the PSMSA have now been terminated and services repatriated to the Bank, with the intention that all will be terminated by the end of 2015 except pensions and membership.

Notes to the Bank financial statements continued

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38. Related party transactions continued

IT separation costs agreement

Under the IT costs separation agreement, both CGL and CFSMS undertake to support activities for the separation of the Bank's IT infrastructure from the wider Co-operative Group's IT infrastructure, to enable the smooth transition to IBM. Further, CGL and CFSMS undertake that any notice to terminate the existing IT services agreement (in the case of CGL) and the CFSMS-Bank Framework Agreement (in the case of CFSMS) would not take effect prior to 31 December 2017 to give the Bank sufficient time to separate the Bank's IT infrastructure. The IT separation costs agreement also allocated the contributions to be made towards The Co-operative Group's own costs of keeping the wider Co-operative Group's existing IT infrastructure stable and operable during and following the Bank's separation of its IT infrastructure; to this end CBGL (as the parent of CFSMS) undertook to contribute a maximum of £95m towards such Co-operative Group costs, with the Bank to make a contribution of up to £25m, based on a formula in the event that the total cost of this Co-operative Group project falls between £76m and £120m.

Deed of surrender and release – Bank ATMs in Group Food stores

On 1 January 2008 the Bank was granted a licence by CGL to install and operate ATMs at a number of Co-operative Food stores in the UK. On 14 April 2014 CGL served notice on the Bank to terminate this licence with effect from 1 January 2016. As part of a new arrangement between CGL and another third party, on 20 November 2014 CGL and the Bank entered into a deed for the Bank to surrender immediately any rights of occupation it may have in relation to these premises. In consideration for this early surrender, CGL paid to the Bank £2.9m, with a further £5.2m to be received in 2015. The Bank entered into a simultaneous agreement with Cardtronics UK Limited for the sale of these ATMs in CGL premises.

CFSMS transactions

CFSMS is a subsidiary of The Co-operative Banking Group and continues to undertake the provision of supplies and services on behalf of the Bank. Further details of the CFSMS – Bank Framework agreement are disclosed below.

CFSMS-Bank Framework

On 16 February 2006, the Bank and CFSMS entered into the CFSMS-Bank Services Agreement pursuant to which CFSMS provides assets such as office equipment, materials and office space, other facilities and services, and consultants who act as secondees to the Bank. The Bank provides CFSMS with an indemnity for all liabilities, losses, damages, costs and expenses of any nature as a result of CFSMS entering into and performing the agreement in respect of the assets, services and personnel provided to the Bank.

The Bank and CFSMS commenced unwinding this arrangement during 2014 with the transfer of the employment of most staff to the Bank (see 'Transfer of Staff from CFSMS to Bank' below), the transfer of assets to the Bank (see 'Tangible and Intangible Assets' below) and the Bank entering in to numerous contracts with third party suppliers to replace those previously provided through CFSMS or the wider the Co-operative Group. These activities continue into 2015, in particular in respect of the Bank's transition of enterprise services to IBM (see note 41).

Tax loss share

As part of the negotiations relating to the separation of the Bank from The Co-operative Group, the Bank and The Co-operative Group also agreed terms relating to the surrender of group relief between the entities in the Bank's tax group and entities in The Co-operative Group tax group. A deed sets out the basis of the agreement by The Co-operative Group to take proactive steps to allow it to maximise its claim for tax losses from the Bank for the accounting periods to 31 December 2012 and 2013. The deed also addresses the terms of the payment by The Co-operative Group to the Bank for those tax losses. The 2014 financial statements, which include a group relief debtor of £126.8m (2013: £126.6m), have been prepared on a basis consistent with the deed. The Bank receives payment from The Co-operative Group when The Co-operative Group realises the benefit of the losses surrendered and at the corporation tax rate at which the benefit is realised.

Transfer of staff from CFSMS to Bank

As explained in relation to the CFSMS-Bank Framework above, from 16 February 2006 CFSMS provided consultants acting as secondees to the Bank. The employment of substantially all Bank dedicated staff provided under that arrangement was transferred to the Bank under the Transfer of Undertakings (Protection of Employment) Regulations, on 23 January 2014.

IT security

The Bank's specialist IT security team will continue to provide an IT security service in relation to the IT infrastructure which the Bank and Co-operative Insurance Services General Insurance Limited (CISGIL) share until that infrastructure is separated. This service comprises of a small number of people. The Bank has historically provided ad hoc IT security services to The Co-operative Group. Whilst no services are currently being provided, the Bank and The Co-operative Group entered in to an agreement to provide a framework for future services on 28 November 2014.

Notes to the Bank financial statements continued

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38. Related party transactions continued

Tangible and intangible assets

A number of assets were originally purchased by CFSMS using funds advanced by the Bank and then provided to the Bank by CFSMS under the 2006 CFSMS-Bank Services Agreement referred to above. In 2013, the Directors of the Bank concluded these assets met the accounting criteria to be shown as assets for the Bank, and therefore reported them on the balance sheet. This is referred to in more detail in the 2013 Annual report and accounts. Legal title of these assets transferred to the Bank in 2014.

As part of the separation activity, in November 2014 the Bank purchased the legal title of all Bank specific assets held by CFSMS (shared assets remained with CFSMS) through an SPV called CBG Asset Management Limited. The carrying value of these assets on the balance sheet at 31 December 2014 is £126.0m (2013: £127.8m).

Balances with The Co-operative Group

The tables below provide an analysis of balances with The Co-operative Group and its undertakings at 31 December 2014 and 31 December 2013 and their location within the Bank's balance sheet.

	2014			
	Loans & advances to customers	**Other assets**	**Customer accounts**	**Other liabilities**
The Co-operative Group	**51.0**	**127.1**	**(163.7)**	**–**
The Co-operative Banking Group Ltd	**–**	**–**	**(55.5)**	**–**
Subsidiaries of The Co-operative Banking Group Ltd	**–**	**35.7**	**(27.3)**	**(126.0)**
	51.0	**162.8**	**(246.5)**	**(126.0)**

	2013			
	Loans & advances to customers	Other assets	Customer accounts	Other liabilities
The Co-operative Group	110.1	126.6	(26.7)	–
The Co-operative Banking Group Ltd	–	303.2	(49.6)	–
Subsidiaries of The Co-operative Banking Group Ltd	–	–	(16.0)	(156.5)
	110.1	429.8	(92.3)	(156.5)

	2014		2013	
	Interest and fees received	**Interest and fees paid**	Interest and fees received	Interest and fees paid
The Co-operative Group	**6.3**	**2.1**	5.0	0.6
The Co-operative Banking Group Ltd	**–**	**–**	–	–
Subsidiaries of The Co-operative Banking Group Ltd	**0.3**	**–**	0.7	–
	6.6	**2.1**	5.7	0.6

A number of transactions are entered into with related parties in the normal course of business on normal commercial terms. These include loans and deposits. Outstanding balances at the year end and related income and expense for the year is presented in the tables above.

Shareholder rights agreement

At the time of the capital raising in May 2014, the Bank entered into a Shareholder Rights Agreement with The Co-operative Group and a number of other investors. As at 31 December 2014, SP COOP INVESTMENTS LTD owns more than 10% of the Bank's ordinary shares and is therefore a related party of the Bank.

The Shareholder Rights Agreement grants certain rights to the shareholders including the right of Silverpoint and Perry Capital (who hold less than 10%) to nominate a Director for appointment to the Board for so long as it continues to own 5% or more of the Bank. In addition, the Shareholder Rights Agreement grants the right for one Director to be appointed to a sub-committee of the Board to assess the feasibility of the Bank listing its ordinary shares on the London Stock Exchange (IPO Committee).

Notes to the Bank financial statements continued

For the year ended 31 December 2014

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38. Related party transactions continued

Transactions with other related parties

Key management, as defined by IAS 24 (Related Party Disclosures), are considered to be Board and Executive members of the Bank, and Board and Executive members of the Bank's immediate and ultimate holding organisations. The volume of related party transactions with key management is provided below:

Directors, key management personnel and close family members

	2014	2013
Loans outstanding at the beginning of the year	**0.3**	2.6
Net movement	**(0.3)**	(2.3)
Loans outstanding at the end of the year	**–**	0.3
Deposits and investments at the beginning of the year	**0.2**	2.4
Net movement	**–**	(2.2)
Deposits and investments at the end of the year	**0.2**	0.2

Directors' loans

	2014			2013		
	Mortgages	**Personal loans**	**Credit cards**	Mortgages	Personal loans	Credit cards
Number of Directors with loan type	**–**	**–**	**–**	1.0	1.0	1.0
Total value of Directors' loans	**–**	**–**	**–**	0.2	–	–

Key management compensation

	2014	2013
Salaries and short term benefits	**6.3**	3.4
Termination benefits	**–**	0.5
	6.3	3.9

Executive Directors' remuneration

A list of the members of the Board of Directors is shown on page 42. The total remuneration of Executive Directors was £3.6m (2013: £2.3m).

Further details of Directors' remuneration are provided in the Directors' Remuneration report.

Notes to the Bank financial statements continued
For the year ended 31 December 2014
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39. Share capital

In plain English:

This note gives details of the share capital of the Bank. You can see the number of shares and also the amount of share capital (the number of shares multiplied by the nominal value of 5p). Share premium arises where new shares are issued at a price above nominal value.

	2014		2013	
	No. of shares (millions)	**Share capital**	No. of shares (millions)	Share capital
Allotted, called up and fully paid (ordinary shares of 5p each)				
At the beginning of the year	**250.0**	**12.5**	8,200.0	410.0
Shares cancelled	**–**	**–**	(8,200.0)	(410.0)
Issue of new ordinary shares	**200.5**	**10.0**	250.0	12.5
Issue of new bonus shares	**1.0**	**0.1**	–	–
At the end of the year	**451.5**	**22.6**	250.0	12.5
Share premium account				
At the beginning of the year		**1,359.8**		8.8
Issue of new ordinary shares		**377.2**		1,351.0
Issue of new bonus shares		**(0.1)**		–
At the end of the year		**1,736.9**		1,359.8

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

The number of ordinary shares in issue at 31 December 2014 was 451,456,510 (2013: 250,000,000). The ordinary shareholders have one vote for every share held.

Liability Management Exercise

This exercise involved issuing new shares and new debt in exchange for cash and extinguishing existing debt and preference shares.

The Bank announced, in November 2013, a Recapitalisation plan to generate £1.5bn additional CET1, which was discussed with the relevant regulatory bodies. The key objective of the plan was to strengthen significantly the Bank's CET1 base with the support and participation of certain holders of the Bank's securities and without the need for support from the taxpayer.

The £1.5bn Recapitalisation plan consisted of three elements:

a) The Liability Management Exercise (LME) to generate c.£1.2bn of new CET1;

b) The commitment of The Co-operative Group to contribute £333m of CET1 by the end of 2014; and

c) £40m of CET1 generated in 2014 from interest savings on the securities surrendered in the LME.

The transaction has been accounted for in accordance with IFRIC 19: Extinguishing Financial Liabilities with Equity Instruments.

Notes to the Bank financial statements continued
For the year ended 31 December 2014
All amounts are stated in £m unless otherwise indicated

39. Share capital continued

Details of the Liability Management Exercise

a) The LME

A core part of the Recapitalisation plan was achieved through successful completion of the LME on 20 December 2013. This involved the following elements:

i. The issuance in 2013 of £0.2bn of new subordinated debt and £0.6m of new ordinary shares in exchange for £1.3bn of existing debt and preference shares and additional contribution from bondholders of £0.1bn;

ii. The cancellation in 2013 of £0.4bn of existing ordinary share capital, which resulted in the creation of a capital redemption reserve of the same value; and

iii. The sale of investment assets that were used as economic hedges for the existing debt, generating a profit of £11.1m, in 2013. These assets had been accounted for as available for sale, and therefore there was an equivalent reduction in the available for sale reserve.

b) The contribution of £333m by The Co-operative Group. This was paid as follows:

i. £20m paid in December 2013;

ii. £50m paid in January 2014;

iii. £100m paid on 30 June 2014; and

iv. £163m paid on 31 December 2014.

c) The balance of the £1.5bn is £40m of savings in 2014 generated on securities surrendered as part of the LME

Elements a) and b) together created additional CET1 in the following ways:

i. New ordinary shares – a total of £0.8bn of new ordinary shares were issued in 2013 to both existing bondholders and The Co-operative Banking Group. This was recorded as share capital and share premium as shown in the table below.

ii. Income – £0.7bn was recognised in the 2013 income statement. This arose because the amount of debt extinguished and contributions received (£1.3bn and £0.4bn) was greater than the amount of the new debt and shares issued (£0.2bn and £0.8bn). In accordance with company law, which requires that the share premium is determined by reference to the amount of debt extinguished, the element of income relating to new shares issues (£0.6bn) was transferred from retained earnings to share premium.

Effect of the Recapitalisation plan on 2013 profit and reserves

		Effect on reserves – 2013					
	Profit	Share capital	Share premium	Available for sale reserve	Capital redemption reserve	Retained earnings	Net effect on reserves
Issuance of new debt and ordinary shares in exchange for existing debt and contributions	707.7	12.5	777.5	–	–	707.7	1,497.7
Sale of assets hedging pre-LME debt positions	11.1	–	–	(11.1)	–	11.1	–
Effect of transactions with a profit impact (before costs)	718.8	12.5	777.5	(11.1)	–	718.8	1,497.7
Costs associated with LME transaction	(30.5)	–	(21.3)	–	–	(30.5)	(51.8)
Effect of transactions with a profit impact (after costs)	688.3	12.5	756.2	(11.1)	–	688.3	1,445.9
Other LME transactions (with no profit impact):							
Cancellation of share capital (capital redemption reserve created)	–	(410.0)	–	–	410.0	–	–
Transfer of retained earnings to share premium account	–	–	594.8	–	–	(594.8)	–
Total effect of recapitalisation transactions on profit and reserves	688.3	(397.5)	1,351.0	(11.1)	410.0	93.5	1,445.9

Notes to the Bank financial statements continued

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

40. Fair values of financial assets and liabilities

In plain English:

This note summarises the total assets and liabilities of the Bank and provides information on how each asset/liability is measured. The note also presents a fair value for the assets/liabilities that are not held at fair value on the Bank balance sheet, along with details of the method of calculation.

In addition, the note provides details of the fair value of the transferred assets and associated liabilities within our securitisation vehicles and covered bonds.

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

Balance sheet categories	Held for trading	Designated at fair value	Loans and receivables	Available for sale	Liabilities at amortised cost	Derivatives in a hedging relationship	Total
2014							
Assets							
Cash and balances at central banks	–	–	4,765.3	–	–	–	4,765.3
Loans and advances to banks	–	–	1,608.4	–	–	–	1,608.4
Loans and advances to customers	3.9	182.7	25,190.8	–	–	–	25,377.4
Fair value adjustments for hedged risk	–	–	148.5	–	–	–	148.5
Investment securities	–	1,236.9	18.1	3,167.5	–	–	4,422.5
Derivative financial instruments	250.6	–	–	–	–	220.1	470.7
Equity shares	–	–	–	2.8	–	–	2.8
Other assets	–	–	187.6	–	–	–	187.6
Total financial assets	254.5	1,419.6	31,918.7	3,170.3	–	220.1	36,983.2
Non-financial assets							599.7
Total assets							37,582.9
Liabilities							
Deposits by banks	–	–	–	–	615.4	–	615.4
Customer accounts	–	–	–	–	29,614.0	–	29,614.0
Customer accounts – capital bonds	–	263.8	–	–	–	–	263.8
Debt securities in issue	–	–	–	–	3,443.6	–	3,443.6
Derivative financial instruments	176.0	–	–	–	–	375.7	551.7
Other borrowed funds	–	–	–	–	196.4	–	196.4
Other liabilities	–	–	–	–	150.9	–	150.9
Total financial liabilities	176.0	263.8	–	–	34,020.3	375.7	34,835.8
Non-financial liabilities							732.6
Total liabilities							35,568.4
Capital and reserves							2,014.5
Total liabilities and equity							37,582.9

IAS 39 requires derivative financial instruments that are not in a hedging relationship to be classified as 'held for trading'; this definition differs from the definition of 'derivatives held for trading purposes' as shown in note 20.

Notes to the Bank financial statements continued

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

40. Fair values of financial assets and liabilities continued

Balance sheet categories	Held for trading	Designated at fair value	Loans and receivables	Available for sale	Liabilities at amortised cost	Derivatives in a hedging relationship	Total
2013 restated[1]							
Assets							
Cash and balances at central banks	–	–	5,418.8	–	–	–	5,418.8
Loans and advances to banks	–	–	1,594.4	–	–	–	1,594.4
Loans and advances to customers	–	134.2	30,151.9	–	–	–	30,286.1
Fair value adjustments for hedged risk	–	–	106.3	–	–	–	106.3
Investment securities	–	1,743.4	23.6	2,732.4	–	–	4,499.4
Derivative financial instruments	252.0	–	–	–	–	303.8	555.8
Equity shares	–	–	–	5.8	–	–	5.8
Other assets	–	–	480.9	–	–	–	480.9
Total financial assets	252.0	1,877.6	37,775.9	2,738.2	–	303.8	42,947.5
Non–financial assets							436.3
Total assets							43,383.8
Liabilities							
Deposits by banks	–	–	–	–	2,757.5	–	2,757.5
Customer accounts	–	–	–	–	32,463.3	–	32,463.3
Customer accounts – capital bonds	–	538.1	–	–	–	–	538.1
Debt securities in issue	–	–	–	–	4,207.6	–	4,207.6
Derivative financial instruments	168.6	–	–	–	–	370.0	538.6
Other borrowed funds	–	–	–	–	196.3	–	196.3
Other liabilities	–	–	–	–	202.9	–	202.9
Total financial liabilities	168.6	538.1	–	–	39,827.6	370.0	40,904.3
Non–financial liabilities							711.0
Total liabilities							41,615.3
Capital and reserves							1,768.5
Total liabilities and equity							43,383.8

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

Notes to the Bank financial statements continued

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

40. Fair values of financial assets and liabilities continued

a) Use of financial instruments

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

Loans and advances to customers and customer accounts

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

Loans and advances to banks and investment securities

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

Deposits by banks and debt securities in issue

The Bank issues medium term notes within an established euro medium term note programme and also issues certificates of deposit and commercial paper as part of its normal treasury activities.

Other borrowed funds

The Bank utilises a broad spread of long term wholesale funding in the form of fixed rate subordinated debt in addition to funding from ordinary share capital and retained earnings. Refer to note 30 for details of changes to other borrowed funds as a result of the LME.

Derivatives

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

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

Foreign exchange

The Bank undertakes foreign exchange dealing to facilitate customer requirements and to generate incremental income from short term trading in the major currencies. Structured risk and trading related risk are managed formally within position limits which are set by ALCO, to which authority is delegated by the Board.

Notes to the Bank financial statements continued

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

40. Fair values of financial assets and liabilities continued

b) Valuation of financial assets and liabilities at fair value

The following tables analyse financial assets and liabilities carried at fair value by the three level fair value hierarchy defined as follows:

- Level 1 – Quoted market prices in active markets
- Level 2 – Valuation techniques using observable inputs
- Level 3 – Valuation techniques using unobservable inputs

	Fair value at end of the reporting period using:			
2014	**Level 1**	**Level 2**	**Level 3**	**Total**
Non-derivative financial assets				
Held for trading:				
Loans and advances to customers	–	3.9	–	3.9
Designated at fair value:				
Loans and advances to customers	–	176.0	6.7	182.7
Investment securities	1,236.9	–	–	1,236.9
Available for sale financial assets:				
Investment securities	3,022.5	145.0	–	3,167.5
Equity shares	0.1	2.7	–	2.8
Derivative financial instruments	–	470.7	–	470.7
Non-financial instruments				
Investment properties	–	–	2.1	2.1
Total assets carried at fair value	4,259.5	798.3	8.8	5,066.6
Non-derivative financial liabilities				
Designated at fair value:				
Customer accounts – capital bonds	–	263.8	–	263.8
Derivative financial instruments	–	551.7	–	551.7
Total liabilities carried at fair value	–	815.5	–	815.5

Notes to the Bank financial statements continued

For the year ended 31 December 2014

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40. Fair values of financial assets and liabilities continued

	Fair value at end of the reporting period using:			
2013	Level 1	Level 2	Level 3	Total
Non-derivative financial assets				
Designated at fair value:				
Loans and advances to customers	–	125.5	8.7	134.2
Investment securities	1,743.4	–	–	1,743.4
Available for sale financial assets:				
Investment securities	2,497.2	235.2	–	2,732.4
Equity shares	0.1	5.7	–	5.8
Derivative financial instruments	–	525.3	30.5	555.8
Non-financial instruments				
Investment properties	–	157.9	6.2	164.1
Total assets carried at fair value	4,240.7	1,049.6	45.4	5,335.7
Non-derivative financial liabilities				
Designated at fair value:				
Customer accounts – capital bonds	–	538.1	–	538.1
Derivative financial instruments	–	477.4	61.2	538.6
Total liabilities carried at fair value	–	1,015.5	61.2	1,076.7

Notes to the Bank financial statements continued

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

40. Fair values of financial assets and liabilities continued

The carrying values of financial instruments measured at fair value are determined in compliance with the accounting policies on pages 154 to 168 and according to the following hierarchy:

Level 1 – Quoted market prices in active markets

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

Level 2 – Valuation techniques using observable inputs

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

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

Loans and advances to customers

Loans and advances to customers include corporate loans of £164.7m (2013: £125.5m) which are fair valued through income or expense using observable inputs. Loans held at fair value are valued at the sum of all future expected cash flows, discounted using a yield curve based on observable market inputs.

Investment securities – available for sale

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

Derivative financial instruments

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

Investment properties

Investment properties are carried at fair value. For those within Level 2 fair value is calculated by using recent valuations of individual assets within the portfolio, indexed linked to the balance sheet date using the relevant regional house price index where appropriate.

Customer accounts – capital bonds

The estimated fair value of customer accounts – capital bonds is based on independent third party valuations using forecast future movements in the appropriate indices.

Equity shares

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

Level 3 – Valuation techniques using unobservable inputs

This is used for financial instruments valued using models where one or more significant inputs are not observable.

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

Loans and advances to customers

Loans and advances to customers include 25 year fixed rate mortgages of £6.7m (2013: £8.7m) which are fair valued through income or expense using unobservable inputs. 25 year fixed rate mortgages are valued using future interest cash flows at the fixed customer rate an estimated schedule of customer repayments. Cash flows are discounted at a credit adjusted discount rate; the credit adjustment is based on the average margin of new long dated (five years or greater) fixed rate business written in the last six months, and subject to quarterly review. The eventual timing of future cash flows may be different from that forecast due to unpredictable customer behaviour, particularly on a 25 year product. The valuation methodology takes account of credit risk and has decreased the valuation by £0.5m in 2014 (2013: £0.8m decrease). A reasonable change in the assumptions would not result in any material change in the valuation.

Notes to the Bank financial statements continued

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

40. Fair values of financial assets and liabilities continued

Derivative financial instruments

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

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

The swaps are valued based on an assumed amortisation profile of the pool of assets to the bond maturity date (assuming some annual prepayment), an assumed profile of customer receipts over this period, and LIBOR prediction using forward rates. Swap cash flows are discounted to present value using mid-yield curve zero coupon rates, ie no adjustment is made for credit losses, nor for transaction or any other costs.

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

	Fair value at the beginning of the year	Purchases and transfers in	Sales and transfers out[1]	Income or expense including impairment	Fair value at the end of the year
2014					
Loans and advances to customers	**8.7**	**–**	**(1.5)**	**(0.5)**	**6.7**
Derivative assets	**30.5**	**–**	**(30.5)**	**–**	**–**
Derivative liabilities	**(61.2)**	**–**	**61.2**	**–**	**–**
Investment properties	**6.2**	**–**	**(4.3)**	**0.2**	**2.1**
	(15.8)	**–**	**24.9**	**(0.3)**	**8.8**
2013					
Loans and advances to customers	11.2	–	(1.7)	(0.8)	8.7
Derivative assets	35.4	12.6	(22.6)	5.1	30.5
Derivative liabilities	(12.4)	(52.0)	0.6	2.6	(61.2)
Investment properties	173.0	–	(166.6)	(0.2)	6.2
	207.2	(39.4)	(190.3)	6.7	(15.8)

1. Sales and transfers out of investment properties in 2013 includes £166.6m of transfers out to level 3. There were no other transfers from level 3 in 2013 or 2014.

Notes to the Bank financial statements continued

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

40. Fair values of financial assets and liabilities continued

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

The carrying values of financial instruments measured at amortised cost are determined in compliance with the accounting policies on pages 154 to 168.

The table below sets out a summary of the carrying and fair values of:

- financial assets classified as loans and receivables; and
- financial liabilities classified as held at amortised cost,

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

	Carrying value	Fair value
2014		
Financial assets		
Loans and advances to banks	**1,608.4**	**1,608.4**
Loans and advances to customers	**25,190.8**	**23,657.6**
Fair value adjustments to hedged risk	**148.5**	**148.5**
Investments securities	**18.1**	**14.3**
Other assets	**187.6**	**187.6**
Financial liabilities		
Deposits by banks	**615.4**	**615.4**
Customer accounts	**29,614.0**	**29,625.6**
Debt securities in issue	**3,443.6**	**3,478.9**
Other borrowed funds	**196.4**	**223.2**
Other liabilities	**150.9**	**150.9**

	Carrying value (restated)[1]	Fair value (restated)[1]	Fair value (apply 2014 methodology)[2]
2013			
Financial assets			
Loans and advances to banks	1,594.4	1,594.4	1,594.4
Loans and advances to customers	30,151.9	27,776.9	27,939.5
Fair value adjustments to hedged risk	106.3	106.3	106.3
Investments securities	23.6	21.4	21.4
Other assets	480.9	480.9	480.9
Financial liabilities			
Deposits by banks	2,757.5	2,757.5	2,757.5
Customer accounts	32,463.3	32,488.3	32,488.3
Debt securities in issue	4,207.6	4,716.1	4,716.1
Other borrowed funds	196.3	234.2	234.2
Other liabilities	202.9	202.9	202.9

1. The 2013 comparatives have been restated as described in note 3.
2. In 2014, the Bank reviewed and improved the methods used to calculate fair values. The 2013 comparatives for loans and advances to customers have been recalculated accordingly to reflect these changes in methods.

Notes to the Bank financial statements continued

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

40. Fair values of financial assets and liabilities continued

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

Loans and advances to banks/deposits by banks

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

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

Loans and advances to customers

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

i. Retail

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

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

ii. Optimum

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

iii. Corporate

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

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

The fair value of loans and advances to customers in total is 96% of the carrying value as at 31 December 2014 (2013 when applying 2014 methodology: 93%). The overall fair values are less than par primarily due to two main factors for Non-core loans in particular:

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

Investment securities

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

Customer accounts

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

Debt securities in issue and other borrowed funds

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

Notes to the Bank financial statements continued

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

40. Fair values of financial assets and liabilities continued

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

Unwind of merger fair value adjustments

On the merger of the Bank and Britannia Building Society in August 2009 an exercise was undertaken to fair value the respective assets and liabilities of Britannia Building Society. These fair value adjustments are unwound on an EIR basis over the effective lives of the assets and liabilities. As at 31 December 2014, the remaining merger fair value unwinds and the forecast unwind profiles can be summarised as follows:

	Carrying amount at year end	Remaining merger fair value to be unwound at year end	Actual unwind for the year to 31 December 2014	Forecast unwind			
				2015	2016	2017	2018+
2014							
Assets							
Loans and advances to customers	**25,377.4**	**(44.8)**	**(10.1)**	**(4.3)**	**(4.0)**	**(3.7)**	**(32.8)**
Fair value adjustment for hedged risk	**148.5**	**(21.0)**	**(16.7)**	**(2.7)**	**(2.5)**	**(2.4)**	**(13.4)**
Other	**12,057.0**	**27.0**	**9.0**	**4.5**	**4.5**	**4.5**	**13.5**
Total assets	**37,582.9**	**(38.8)**	**(17.8)**	**(2.5)**	**(2.0)**	**(1.6)**	**(32.7)**
Liabilities							
Debt securities in issue	**3,443.6**	**(378.6)**	**(109.2)**	**(144.6)**	**(176.0)**	**(58.0)**	**–**
Deferred tax liabilities	**84.0**	**76.4**	**16.5**	**29.8**	**36.4**	**11.9**	**(1.7)**
Other	**32,040.8**	**–**	**0.5**	**–**	**–**	**–**	**–**
Total liabilities	**35,568.4**	**(302.2)**	**(92.2)**	**(114.8)**	**(139.6)**	**(46.1)**	**(1.7)**

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

Issue name	Issue date	Contractual maturity date	Carrying amount at year end	Fair value at year end	Remaining merger fair value to be unwound at year end	Actual unwind for the year to 31 December 2014	Forecast unwind		
							2015	2016	2017
2014									
Leek Finance Number Seventeen plc	**April 2006**	**June 2016**	**581.5**	**585.9**	**77.0**	**36.6**	**47.5**	**29.5**	**–**
Leek Finance Number Eighteen plc	**October 2006**	**December 2016**	**724.2**	**722.9**	**123.4**	**39.7**	**51.4**	**72.0**	**–**
Leek Finance Number Nineteen plc	**April 2007**	**June 2017**	**712.8**	**710.9**	**186.7**	**35.8**	**49.7**	**78.1**	**58.9**
Total Leek Notes			**2,018.5**	**2,019.7**	**387.1**	**112.1**	**148.6**	**179.6**	**58.9**

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

Issue name	Carrying amount at year end	Fair value at year end	Remaining merger fair value to be unwound at year end	Actual unwind for the year to 31 December 2014	Forecast unwind		
					2015	2016	2017
2014							
Internally Held Leek Notes	**549.6**	**544.7**	**8.6**	**4.2**	**4.1**	**3.6**	**0.9**

Notes to the Bank financial statements continued

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

40. Fair values of financial assets and liabilities continued

Fair values of financial assets and liabilities which are not carried at fair value and bases of valuation

Fair values are determined according to the hierarchy set out on page 230.

	Carrying value	Level 1	Level 2	Level 3
2014				
Financial assets				
Loans and receivables:				
Loans and advances to banks	**1,608.4**	**–**	**1,608.4**	**–**
Loans and advances to customers	**25,190.8**	**–**	**–**	**23,657.6**
Fair value adjustment for hedged risk	**148.5**	**–**	**–**	**148.5**
Investment securities	**18.1**	**14.3**	**–**	**–**
Financial liabilities				
Financial liabilities at amortised cost:				
Deposits by banks	**615.4**	**–**	**615.4**	**–**
Customer accounts	**29,614.0**	**–**	**29,625.6**	**–**
Debt securities in issue	**3,443.6**	**789.1**	**2,689.8**	**–**
Other borrowed funds	**196.4**	**–**	**223.2**	**–**

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

	Carrying value	Level 1	Level 2	Level 3
2013				
Financial assets				
Loans and receivables:				
Loans and advances to banks	1,594.4	–	1,594.4	–
Loans and advances to customers[1]	30,151.9	–	–	27,939.5
Fair value adjustment for hedged risk	106.3	–	–	106.3
Investment securities	23.6	21.4	–	–
Financial liabilities				
Financial liabilities at amortised cost:				
Deposits by banks	2,757.5	–	2,757.5	–
Customer accounts	32,463.3	–	32,488.3	–
Debt securities in issue	4,207.6	892.5	3,822.4	–
Other borrowed funds	196.3	–	234.2	–

1. The 2013 fair value of loans and advances to customers has been recalculated using the 2014 methodology. Using the 2013 methodology, the comparative, restated as described in note 3, is £27,776.9m.

Notes to the Bank financial statements continued

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

40. Fair values of financial assets and liabilities continued

d) Fair value of transferred assets and associated liabilities

Securitisation vehicles

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

The securitisation vehicles have issued fixed and floating rate notes which are secured on the loans and advances to customers. The notes are redeemable in part from time to time, such redemptions being limited to the net capital received from mortgagors in respect of the underlying assets.

The Bank retains substantially all of the risks and rewards of ownership. The Bank benefits to the extent to which surplus income generated by the transferred mortgage portfolios exceeds the administration costs of those mortgages. The Bank continues to bear the credit risk of these mortgage assets.

The results of the securitisation vehicles listed in note 24 of the Company's Financial Statements are consolidated into the results of the Bank. The table below shows the carrying values and fair values of the assets transferred to securitisation vehicles and their associated liabilities. The carrying values presented below are the carrying amounts as recorded in the books of the subsidiary companies, some of these issued notes are held internally by the Bank and as such are not shown in the consolidated balance sheet of the Group.

In 2014, the Bank reviewed and improved the methods used to calculate the fair values. The 2013 comparatives (with the exception of fair value adjustment for hedged risk and customer accounts) have been re-calculated accordingly to reflect these changes in methods.

	Carrying amount of transferred assets not derecognised	Carrying amount of associated liabilities	Fair value of transferred assets not derecognised	Fair value of associated liabilities	Net position
2014					
Leek Finance Number Seventeen plc	**554.0**	**581.5**	**403.1**	**585.9**	**(182.8)**
Leek Finance Number Eighteen plc	**662.9**	**724.2**	**485.0**	**722.9**	**(237.9)**
Leek Finance Number Nineteen plc	**642.9**	**712.8**	**473.6**	**710.9**	**(237.3)**
Leek Finance Number Twenty plc	**1,340.1**	**1,319.7**	**1,338.9**	**1,269.6**	**69.3**
Leek Finance Number Twenty One plc	**763.6**	**775.4**	**788.6**	**719.3**	**69.3**
Leek Finance Number Twenty Two plc	**351.1**	**366.4**	**365.3**	**341.7**	**23.6**
Silk Road Finance Number One plc	**1,126.0**	**1,135.6**	**1,126.0**	**1,130.4**	**(4.4)**
Silk Road Finance Number Three plc	**451.3**	**459.8**	**457.7**	**463.1**	**(5.4)**
Cambric Finance Number One plc	**883.4**	**902.0**	**986.2**	**878.3**	**107.9**
Meerbrook Finance Number Eight plc	**564.5**	**564.5**	**570.3**	**458.2**	**112.1**
	7,339.8	**7,541.9**	**6,994.7**	**7,280.3**	**(285.6)**

The above carrying amount of associated liabilities can be reconciled to debt securities in issue, as set out on page 202, as follows:

	Carrying value
Carrying amount of associated liabilities as given above	**7,541.9**
Internally held fixed and floating rate notes	**(4,756.0)**
Loan facilities and subdebt not included in debt securities in issue	**(506.1)**
Non-securitised debt securities	**1,536.7**
Merger fair value adjustment	**(387.1)**
Other adjustments	**14.2**
Debt securities in issue per financial liabilities	**3,443.6**

Notes to the Bank financial statements continued

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

40. Fair values of financial assets and liabilities continued

Of the notes listed above, those held by the Bank are as follows:

	Carrying amount of transferred assets not derecognised	Carrying amount of associated liabilities	Fair value of assets not derecognised	Fair value of associated liabilities	Net position
2014					
Leek Finance Number Seventeen plc	150.4	155.8	136.4	154.8	(18.4)
Leek Finance Number Eighteen plc	180.9	195.6	164.7	189.7	(25.0)
Leek Finance Number Nineteen plc	182.5	198.2	165.7	200.2	(34.5)
Leek Finance Number Twenty plc	1,340.1	1,319.7	1,338.9	1,269.6	69.3
Leek Finance Number Twenty One plc	763.6	775.4	788.6	719.3	69.3
Leek Finance Number Twenty Two plc	351.1	366.4	365.3	341.7	23.6
Silk Road Finance Number One plc	844.4	734.9	793.8	728.7	65.1
Silk Road Finance Number Three plc	120.9	108.0	117.2	107.2	10.0
Cambric Finance Number One plc	883.4	902.0	986.2	878.3	107.9
	4,817.3	4,756.0	4,856.8	4,589.5	267.3

The above carrying value and fair value of assets held for each entity has been determined by applying the proportion of internally held liabilities.

Transferred assets include securitised gilts and loans and advances to customers that have not been derecognised by the seller. The associated liabilities include the fixed and floating rate notes, bank loans and intercompany loans that specifically relate to the funding for the assets securitised.

The difference between the fair value and carrying value of the mortgages that have been securitised within Leek 17, 18 and 19 is significantly higher than the fair value to carrying value difference for the associated liabilities. This is because it is expected that the notes will be repaid at par at the call date of the Leek liabilities whereas most of the mortgages will continue to be held on the Bank's balance sheet for a significant period after the notes have been repaid and these mortgages have an interest rate which is below the equivalent market rate at the balance sheet date for loans of a similar nature.

The securitisation vehicles receive cash daily in relation to the transferred loans and advances and semi-annually for the transferred gilts. These amounts are held within loans and advances to banks until the associated liabilities' payments are due. Payments are made quarterly for all associated liabilities except for the variable funding notes associated with the transferred gilts, which are paid semi-annually. The amounts held within loans and advances to banks are not included in the table above but will be used in part to cover the repayments made on the associated liabilities.

Notes to the Bank financial statements continued

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

40. Fair values of financial assets and liabilities continued

The following table provides the fair value of the transferred assets and associated liabilities for 2013 recalculated on the basis of the new methodology applied in 2014.

	Carrying amount of transferred assets not derecognised	Carrying amount of associated liabilities	Fair value of assets not derecognised	Fair value of associated liabilities	Net position
2013 – applying 2014 fair value methodology					
Leek Finance Number Seventeen plc	588.8	624.6	605.3	619.4	(14.1)
Leek Finance Number Eighteen plc	703.1	762.5	690.1	748.1	(58.0)
Leek Finance Number Nineteen plc	680.5	749.6	670.9	737.1	(66.2)
Leek Finance Number Twenty plc	1,438.2	1,413.3	1,419.5	1,364.0	55.5
Leek Finance Number Twenty One plc	850.1	864.1	872.1	784.6	87.5
Leek Finance Number Twenty Two plc	372.6	389.0	383.6	356.0	27.6
Silk Road Finance Number One plc	1,466.4	1,481.2	1,461.5	1,486.3	(24.8)
Silk Road Finance Number Two plc	562.0	561.1	573.7	563.4	10.3
Silk Road Finance Number Three plc	583.1	597.9	588.2	604.6	(16.4)
Cambric Finance Number One plc	1,339.8	1,384.5	1,425.2	1,310.9	114.3
Meerbrook Finance Number Eight plc	625.9	635.8	760.1	601.4	158.7
	9,210.5	9,463.6	9,450.2	9,175.8	274.4

	Carrying amount of transferred assets not derecognised	Carrying amount of associated liabilities	Fair value of assets not derecognised	Fair value of associated liabilities	Net position
2013 – as per published report and accounts					
Leek Finance Number Seventeen plc	588.8	624.6	490.9	619.4	(128.5)
Leek Finance Number Eighteen plc	703.1	762.5	592.3	748.1	(155.8)
Leek Finance Number Nineteen plc	680.5	749.6	573.0	737.1	(164.1)
Leek Finance Number Twenty plc	1,438.2	1,413.3	1,135.1	1,364.0	(228.9)
Leek Finance Number Twenty One plc	850.1	864.1	770.1	784.6	(14.5)
Leek Finance Number Twenty Two plc	372.6	389.0	309.1	356.0	(46.9)
Silk Road Finance Number One plc	1,466.4	1,481.2	1,466.4	1,486.3	(19.9)
Silk Road Finance Number Two plc	562.0	561.1	562.5	563.4	(0.9)
Silk Road Finance Number Three plc	583.1	597.9	584.2	604.6	(20.4)
Cambric Finance Number One plc	1,339.8	1,384.5	1,238.8	1,310.9	(72.1)
Meerbrook Finance Number Eight plc	625.9	635.8	616.1	601.4	14.7
	9,210.5	9,463.6	8,338.5	9,175.8	(837.3)

Notes to the Bank financial statements continued

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

40. Fair values of financial assets and liabilities continued

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 totaling £0.6bn. As a result of these changes, at the period end the Bank held a loan of £0.6bn (31 December 2013: £0.6bn) and a capital contribution of £0.7bn (2013: £0.9bn) with Moorland Covered Bonds LLP.

Moorland Covered Bonds LLP does not have ordinary share capital. The Bank's interest in Moorland Covered Bonds LLP is in substance no different from a wholly owned subsidiary and consequently it is fully consolidated in the Consolidated Bank accounts. The table below shows the carrying values and fair values of the assets transferred to the covered bond and their associated liabilities:

	Carrying amount of transferred loans and advances to customers	Carrying amount of fixed and floating rate notes	Fair value of transferred loans and advances to customers	Fair value of fixed and floating rate notes	Net position
2014					
Moorland Covered Bonds LLP	**1,092.1**	**596.5**	**1,084.9**	**671.5**	**413.4**
2013					
Moorland Covered Bonds LLP	1,448.8	596.1	1,417.9	628.4	789.6

Assets pledged

Assets are pledged as collateral under repurchase agreements with other banks. These deposits are not available to finance the Consolidated Bank's day-to-day operations.

	Carrying amount of assets not derecognised	Carrying amount of associated liabilities	Fair value of assets not derecognised	Fair value of associated liabilities	Net position
2014					
Investments securities sold under repurchase agreements	**–**	**–**	**–**	**–**	**–**
2013					
Investments securities sold under repurchase agreements	1,004.4	1,028.3	1,022.5	1,028.3	(5.8)

The Bank has repo transactions of £500m that are secured by its own issued retained securitisation notes which are not recognised on the Balance sheet as it relates to structures for which its assets didn't meet the de-recognition criteria. At the end of 2013 the Bank had a number of gilt repos in place which no longer existed at the end of 2014.

41. Post balance sheet events

It is a requirement of IAS 10 (Events after the balance sheet date) that these financial statements reflect events arising after 31 December 2014. The following events have occurred between 31 December 2014 and 26 March 2015 (the date of approval of these financial statements) and represent 'non-adjusting' post balance sheet events:

Migration of IT Infrastructure

On 23 January 2015 the Bank entered into a contract with IBM to migrate its IT infrastructure from The Co-operative Group into IBM managed data centres. The Bank will pay IBM £93m to lead and implement the transition of these services to IBM data centres. The Bank has also entered into a 10 year managed service contract at a total ongoing cost of £275m and has options to terminate throughout the life of the contract.

The Company financial statements

The Company balance sheet

At 31 December 2014

All amounts are stated in £m unless otherwise indicated

	Note	2014	Restated 2013	Restated 2012
Assets				
Cash and balances at central banks	4	**4,765.3**	5,418.8	5,433.0
Loans and advances to banks	5	**670.1**	579.9	1,047.2
Loans and advances to customers	6a	**15,976.2**	20,296.8	22,773.1
Fair value adjustments for hedged risk	6b	**150.8**	106.3	354.1
Investment securities – loans and receivables	7a	**73.5**	83.1	355.4
Investment securities – available for sale	7b	**2,828.6**	2,477.2	3,563.9
Investment securities – fair value through income or expense	7c	**1,236.9**	1,743.4	1,845.2
Investment securities – held for trading		**–**	–	960.2
Derivative financial instruments	8	**289.5**	324.9	590.9
Equity shares	9	**2.8**	5.8	5.7
Non-current assets classified as held for sale	3	**332.5**	–	–
Investments in Co-operative Bank undertakings	24	**1,061.5**	1,453.4	1,808.5
Investment properties	11	**2.1**	1.9	1.8
Property, plant and equipment	12	**63.1**	79.9	95.5
Intangible fixed assets	10	**103.4**	109.9	262.1
Amounts owed by other Co-operative Bank undertakings	25	**12,599.2**	11,886.8	12,357.0
Amounts owed by Co-operative Group undertakings		**–**	–	56.4
Other assets	13	**221.6**	466.6	67.3
Prepayments and accrued income	14	**11.8**	15.7	14.0
Current tax assets		**–**	–	154.0
Deferred tax assets	22	**2.5**	2.8	138.8
Total assets		**40,391.4**	45,053.2	51,884.1
Liabilities				
Deposits by banks	15	**605.1**	2,863.3	3,552.9
Customer accounts		**28,820.4**	31,185.9	33,750.3
Customer accounts – capital bonds	16	**263.8**	527.3	867.2
Debt securities in issue	17	**1,433.1**	1,503.9	1,751.8
Derivative financial instruments	8	**595.5**	531.0	922.6
Other borrowed funds	18	**196.4**	196.3	1,258.6
Amounts owed to other Co-operative Bank undertakings	25	**6,033.0**	5,954.3	7,697.0
Amounts owed to Co-operative Group undertakings		**–**	–	190.0
Other liabilities	19	**152.9**	200.5	99.5
Accruals and deferred income	20	**12.3**	51.9	15.5
Provisions for liabilities and charges	21	**546.3**	461.2	136.8
Current tax liabilities		**0.3**	4.4	–
Deferred tax liabilities	22	**–**	–	–
Total liabilities		**38,659.1**	43,480.0	50,242.2

The Company balance sheet continued
At 31 December 2014

All amounts are stated in £m unless otherwise indicated

	Note	2014	Restated 2013	Restated 2012
Capital and reserves attributable to the Company's equity holders				
Ordinary share capital	26	**22.6**	12.5	410.0
Share premium account	26	**1,736.9**	1,359.8	8.8
Retained earnings		**(520.8)**	(208.1)	1,139.2
Available for sale reserve		**24.7**	(14.1)	30.0
Capital redemption reserve		**410.0**	410.0	–
Cash flow hedging reserve		**58.9**	13.1	53.9
Total equity		**1,732.3**	1,573.2	1,641.9
Total liabilities and equity		**40,391.4**	45,053.2	51,884.1

The 2013 and 2012 balance sheet comparatives have been restated as described in note 1.

The notes on pages 246 to 279 form part of these financial statements.

Approved by the Board on 26 March 2015:

Dennis Holt, Chairman
Niall Booker, Chief Executive

The Company statement of cash flows

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

	2014	Restated 2013
Cash flows from operating activities		
Loss before taxation	**(384.6)**	(608.8)
Adjustments for:		
Decrease in prepayments and accrued income	**3.9**	4.2
Increase/(decrease) in accruals and deferred income	**(39.6)**	15.8
Interest payable in respect of other borrowed funds	**22.8**	96.0
Effect of exchange rate movements	**3.8**	(0.6)
Fair value of movements on investment properties	**(0.2)**	(0.1)
Impairment losses on loans and advances	**(151.9)**	404.9
Movements on investment impairments	**(20.0)**	(18.5)
Depreciation and amortisation	**39.2**	38.7
Interest amortisation	**0.6**	(4.2)
Fair value movements and amortisation of investment securities	**(96.0)**	193.9
Impairment of property, plant and equipment	**12.2**	11.3
Impairment of intangible assets	**7.6**	142.0
Loss on disposal of property, plant, equipment and software	**(0.2)**	–
Non-cash effect of LME transaction	**–**	(688.3)
Unwind of fair value adjustments arising on transfer of engagements	**–**	(86.4)
Preference dividend	**–**	5.4
	(602.4)	(494.7)
Decrease in deposits by banks	**(2,258.2)**	(689.6)
Decrease in customer accounts and capital bonds	**(2,629.0)**	(2,996.4)
Decrease in debt securities in issue	**(70.8)**	(251.1)
Decrease in loans and advances to banks	**5.3**	184.0
Decrease in loans and advances to customers	**4,471.9**	2,462.9
(Decrease)/increase in amounts owed by Co-operative Bank undertakings	**(712.4)**	470.2
Decrease/(increase) in amounts owed to Co-operative Bank undertakings	**78.7**	(1,742.7)
Net movement of other assets and other liabilities	**(242.7)**	59.2
Income tax received	**5.6**	56.5
Net cash flows from operating activities	**(1,954.0)**	(2,941.7)
Cash flows from investing activities		
Purchase of tangible and intangible fixed assets	**(61.7)**	(26.8)
Proceeds from sale of fixed assets	**8.3**	2.2
Purchase of investment securities	**(1,352.0)**	(4,100.3)
Proceeds from sale and maturity of investment securities	**1,732.1**	6,358.8
Net movement on investments in Co-operative Bank undertakings	**391.9**	355.1
Net cash flows from investing activities	**718.6**	2,589.0

The Company statement of cash flows continued

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

	2014	Restated 2013
Cash flows from financing activities		
Interest paid on other borrowed funds	**(22.8)**	(83.9)
Preference share dividends paid	**–**	(5.9)
Capital commitment received from The Co-operative Group	**313.0**	–
Costs incurred relating to the May 2014 Capital Raise	**(12.8)**	–
Cash proceeds relating to the May 2014 Capital Raise	**400.0**	145.0
Net cash flows from financing activities	**677.4**	55.2
Decrease in cash and cash equivalents	**(558.0)**	(297.5)
Cash and cash equivalents at the beginning of the financial year	**5,931.9**	6,229.4
Cash and cash equivalents at the end of the financial year	**5,373.9**	5,931.9
Cash and balances with central banks (note 4)	**4,707.5**	5,352.6
Loans and advances to banks (note 5)	**666.4**	579.3
	5,373.9	5,931.9

The 2013 comparatives have been restated as described in note 1.

The notes on pages 246 to 279 form part of these financial statements.

The Company statement of changes in equity

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

	Attributable to equity holders of the Company						
	Share capital	Share premium	Available for sale reserve	Cash flow hedging reserve	Capital redemption reserve	Retained earnings	Total equity
2014							
Balance at the beginning of the year	**12.5**	**1,359.8**	**(14.1)**	**13.1**	**410.0**	**(208.1)**	**1,573.2**
Total comprehensive (expense)/income for the year	**–**	**–**	**38.8**	**45.8**	**–**	**(312.7)**	**(228.1)**
Transactions with owners recorded directly in equity:							
Liability Management Exercise							
Issuance of new share capital	**10.1**	**377.1**	**–**	**–**	**–**	**–**	**387.2**
Balance at the end of the year	**22.6**	**1,736.9**	**24.7**	**58.9**	**410.0**	**(520.8)**	**1,732.3**
2013							
Balance at the beginning of the year (restated)	410.0	8.8	30.0	53.9	–	1,139.2	1,641.9
Total comprehensive (expense)/income for the year excluding LME	–	–	(33.0)	(40.8)	–	(1,440.8)	(1,514.6)
Total comprehensive (expense)/income for the year – LME	–	–	(11.1)	–	–	688.3	677.2
Total comprehensive (expense)/income for the year	–	–	(44.1)	(40.8)	–	(752.5)	(837.4)
Transactions with owners recorded directly in equity:							
Liability Management Exercise							
Cancellation of share capital	(410.0)	–	–	–	410.0	–	–
Issuance of new share capital	12.5	777.5	–	–	–	–	790.0
Transfer of retained earnings to share premium	–	594.8	–	–	–	(594.8)	–
Transaction costs	–	(21.3)	–	–	–	–	(21.3)
Balance at the end of the year (restated)	12.5	1,359.8	(14.1)	13.1	410.0	(208.1)	1,573.2

The comparatives have been restated as described in note 1.

The notes on pages 246 to 279 form part of these financial statements.

Notes to the Company financial statements

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

1. Restatement

This note provides details of restatements for hedge accounting, IFRIC 21 levies, Corporate interest fair value and effective interest rate (EIR).

Hedge accounting

In accordance with the Accounting Volatility Management Strategy, the Company elects to make use of different hedge accounting techniques in order to eliminate (as far as possible) any profit or loss generated purely through the implementation of accounting standards (as opposed to actual economic losses).

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

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

The effect of the restatement was to reduce the balance sheet by £1.0m by reducing the cash flow hedging reserve by £1.8m, increasing retained earnings by £0.8m and reducing debt securities in issue by £0.3m. The other side of the entry reducing investment security assets by £1.3m. The movement in retained earnings and cash flow hedge reserve includes a £2.2m credit tax adjustment relating to hedge accounting.

IFRIC 21 Levies

The interpretation addresses the accounting for a liability to pay a levy if that levy is within the scope of IAS 37 Provisions, Contingent Liabilities and Contingent Assets. It also addresses the accounting for a liability to pay a levy whose timing and amount is uncertain.

The guidance provided by IFRIC 21 has led to a change in the timing for the recognition of Financial Services Compensation Scheme (FSCS) levies that impact the Company.

The FSCS provided compensation to consumers following the collapse of a number of deposit takers. The compensation paid out to consumers is currently funded through loans from the Bank of England and HM Treasury. In order to repay the loan principal, which is not expected to be recovered, the FSCS levies participating financial institutions.

The ultimate FSCS levy to the industry as a result of the collapses cannot currently be estimated reliably as it is dependent on various uncertain factors, including the potential recoveries of assets by the FSCS and changes in the level of protected deposits and the population of FSCS members at the time.

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

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

The effect of the restatement was to reduce provisions and increase retained earnings by £26.3m, being a reduction in provisions of £24.8m and a credit to the income statement of £1.5m.

Corporate interest fair value

The £9.0m adjustment to Corporate interest fair value asset was the result of a reassessment of the remaining lives of the individual loans, against which the interest fair value was calculated. This exercise was undertaken during 2014 and was applied retrospectively to prior years, resulting in a £9.0m credit to the loans and advances customer balance.

The impact of similar adjustments to subsidiaries of the Company resulted in a reduction in the group relief surrendered to those subsidiaries, reducing the group relief debtor held within other assets by £3.4m.

Effective Interest Rate (EIR)

During 2014 the Company implemented a more accurate model to account for its fixed rate mortgages on an amortised cost basis. This adjustment was applied retrospectively, resulting in a £12.4m reduction in the loans and advances to customer balance in 2012.

Deferred tax restatement

The Company has recognised a deferred tax asset of £2.8m which offsets against deferred tax liabilities in its subsidiaries of the same amount.

Notes to the Company financial statements continued

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

Statement of financial position	Note	1 January 2013 (as reported)	Adjustment	1 January 2013 (restated)	31 December 2013 (as reported)	Adjustment	31 December 2013 (restated)
Assets							
Loans and advances to customers	6a	22,785.5	(12.4)	22,773.1	20,318.2	(21.4)	20,296.8
Fair value adjustments for hedged risk	6b		–		107.6	(1.3)	106.3
Other assets	13		–		470.0	(3.4)	466.6
Deferred tax assets			–		–	2.8	2.8
Liabilities							
Debt securities in issue	17	1,752.2	(0.4)	1,751.8	1,504.2	(0.3)	1,503.9
Provisions for liabilities and charges	21	161.6	(24.8)	136.8	487.5	(26.3)	461.2
Reserves							
Retained earnings		1,116.9			(213.2)		
EIR adjustment			(12.4)			(12.4)	
Adjustment re FSCS levy			24.8			26.3	
Corporate fair value adjustment						(9.0)	
Tax adjustments						(0.6)	
Adjustment for hedge accounting			9.9			0.8	
		1,116.9	22.3	1,139.2	(213.2)	5.1	(208.1)
Cash flow hedging reserve		63.4	(9.5)	53.9	14.9	(1.8)	13.1

2. Net loss attributable to equity shareholders of the Company

On including the Company financial statements here together with the Bank financial statements, the 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.

	2014	2013
Net loss attributable to equity shareholders of the Company	**(312.7)**	(752.5)

The net loss attributable to the equity holders of the Company has been restated for 2013 as described in note 1.

3. Non-current assets classified as held for sale

	Non-current assets	Disposal group	**2014**	2013
Property, plant and equipment (note 12)	9.1	–	**9.1**	–
Intangible assets	–	–	**–**	–
Loans and advances to customers (note 6a)	–	323.4	**323.4**	–
Cash and cash equivalents	–	–	**–**	–
Other receivables	–	–	**–**	–
Investment in Group undertakings	–	–	**–**	–
	9.1	323.4	**332.5**	–

The non-current assets presented as held for sale relate to the ATM transaction which is expected to complete in 2015 and has been approved by management.

The disposal group relates to the sale of a large scale renewable energy asset portfolio which is expected to complete in 2015 and has been approved by management.

No impairment losses or gains were recognised on classification of the ATMs as held for sale assets.

For more information see note 15 in the Bank financial statements.

Notes to the Company financial statements continued

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

4. Cash and balances at central banks

	2014	2013
Cash in hand	**218.0**	274.9
Balances with the Bank of England other than mandatory reserve deposits	**4,489.5**	5,077.7
Included in cash and cash equivalents	**4,707.5**	5,352.6
Mandatory reserve deposits with the Bank of England	**57.8**	66.2
	4,765.3	5,418.8

Mandatory reserve deposits are not available for use in the Company's day-to-day operations, are non-interest bearing and are not included in cash and cash equivalents.

5. Loans and advances to banks

	2014	2013
Items in course of collection from other banks	**49.3**	105.1
Placements with other banks	**617.1**	474.2
Included in cash and cash equivalents	**666.4**	579.3
Other loans and advances to banks	**3.7**	0.6
	670.1	579.9

6. a) Loans and advances to customers

	Classified as held for sale	Not classified as held for sale	Total 2014	Restated 2013
Gross loans and advances	**323.4**	**16,321.5**	**16,644.9**	20,975.2
Less: allowance for losses	**–**	**(345.3)**	**(345.3)**	(678.4)
	323.4	**15,976.2**	**16,299.6**	20,296.8

The 2013 comparatives have been restated as described in note 1.

Loans and advances to customers include £171.4m (2013: £134.2m) of financial assets at fair value through income or expense designated at initial recognition to eliminate or significantly reduce a measurement or recognition inconsistency, and £3.9m of financial assets held for trading (2013: nil). Of these, £78.4m (2013: £62.9m) are secured by real estate collateral.

Loans and advances to customers include £7,899.6m (2013: £10,111.9m) securitised under the Bank's securitisation and covered bond programmes. The Company remains exposed to substantially all of the risks and rewards of ownership of these assets. Included within amounts owed by Co-operative Bank undertakings in the Company are £4,532.6m (2013: £5,614.1m) of floating rate notes issued to the Company and £1,568.4m (2013: £1,103.4m) of other loans, secured on these mortgage assets.

Allowance for losses on loans and advances

	Core		Non-core (corporate)		
	Individual	Collective	Individual	Collective	Total
2014					
At the beginning of the year	**3.0**	**166.7**	**474.8**	**33.9**	**678.4**
Balances with debt collection agencies	**–**	**39.6**	**–**	**–**	**39.6**
Charge/(release) against profits	**1.0**	**(3.1)**	**(128.1)**	**(22.3)**	**(152.5)**
Amounts written off	**(0.8)**	**(89.9)**	**(121.5)**	**–**	**(212.2)**
Unwind of discount allowance	**–**	**(4.2)**	**(3.9)**	**–**	**(8.1)**
Interest charged on impaired loans	**–**	**–**	**0.1**	**–**	**0.1**
At the end of the year	**3.2**	**109.1**	**221.4**	**11.6**	**345.3**

Notes to the Company financial statements continued
For the year ended 31 December 2014
All amounts are stated in £m unless otherwise indicated

Core provisions are analysed in further detail below:

	Core				
	Retail		BaCB		
	Individual	**Collective**	**Individual**	**Collective**	**Total Core**
2014					
At the beginning of the year	**2.5**	**161.4**	**0.5**	**5.3**	**169.7**
Balances with debt collection agencies	**–**	**39.6**	**–**	**–**	**39.6**
Charge/(release) against profits	**(0.3)**	**–**	**1.3**	**(3.1)**	**(2.1)**
Amounts written off	**(0.4)**	**(89.9)**	**(0.4)**	**–**	**(90.7)**
Unwind of discount allowance	**–**	**(4.2)**	**–**	**–**	**(4.2)**
Interest charged on impaired loans	**–**	**–**	**–**	**–**	**–**
At the end of the year	**1.8**	**106.9**	**1.4**	**2.2**	**112.3**

	Core		Non-core (corporate)		
	Individual	Collective	Individual	Collective	Total
2013					
At the beginning of the year	2.8	174.4	228.5	12.5	418.2
Charge against profits	0.9	37.8	335.0	21.4	395.1
Amounts written off	(0.7)	(41.9)	(84.6)	–	(127.2)
Unwind of discount allowance	–	(3.6)	(4.5)	–	(8.1)
Interest charged on impaired loans	–	–	0.4	–	0.4
At the end of the year	3.0	166.7	474.8	33.9	678.4

Core provisions are analysed in further detail below:

	Core				
	Retail		BaCB		
	Individual	Collective	Individual	Collective	Total Core
2013					
At the beginning of the year	2.5	173.3	0.3	1.1	177.2
Charge against profits	0.3	32.5	0.6	5.3	38.7
Amounts written off	(0.3)	(40.8)	(0.4)	(1.1)	(42.6)
Unwind of discount allowance	–	(3.6)	–	–	(3.6)
Interest charged on impaired loans	–	–	–	–	–
At the end of the year	2.5	161.4	0.5	5.3	169.7

Notes to the Company financial statements continued
For the year ended 31 December 2014
All amounts are stated in £m unless otherwise indicated

6. a) Loans and advances to customers continued

Loans and advances to customers include finance lease receivables:

	2014	2013
Gross investment in finance leases may be analysed as follows:		
No later than one year	**8.3**	12.7
Later than one year and no later than five years	**31.5**	35.7
Later than five years	**46.8**	47.4
	86.6	95.8
Unearned future finance income on finance leases	**(25.6)**	(26.0)
Net investment in finance leases	**61.0**	69.8
The net investment in finance leases may be analysed as follows:		
No later than one year	**4.6**	8.9
Later than one year and no later than five years	**19.8**	23.9
Later than five years	**36.6**	37.0
	61.0	69.8

There are no unguaranteed residual values for any of the finance leases.

6. b) Fair value adjustments for hedged risk

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

	2014	Restated 2013
Gross fair value adjustments for hedged risk	**199.1**	153.1
Less: impairment provision	**(48.3)**	(46.8)
	150.8	106.3

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

	2014	2013
At the beginning of the year	**46.8**	37.0
Charge against profits	**1.5**	9.8
At the end of the year	**48.3**	46.8

The 2013 balances have been restated as described in note 1.

Notes to the Company financial statements continued

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

7. Investment securities

a) Loans and receivables

	2014	2013
Loans and receivables		
Listed	**73.5**	83.1
Unlisted	**–**	–
	73.5	83.1
Less: allowance for losses	**–**	–
	73.5	83.1
Included in cash and cash equivalents	**–**	–

The movement in investment securities – loans and receivables excluding interest amounts is summarised as follows:

	2014	2013
At the beginning of the year	**83.0**	355.1
Acquisitions	**–**	–
Disposals and maturities	**(12.4)**	(291.0)
Exchange adjustments	**(3.8)**	0.9
Fair value movements through income or expense	**–**	(9.2)
Amortisation	**4.7**	27.2
Release of impairment provision	**–**	–
At the end of the year	**71.5**	83.0

b) Available for sale

	2014	2013
Available for sale		
Listed	**2,828.6**	2,477.2
Unlisted	**–**	20.0
	2,828.6	2,497.2
Less: allowance for losses	**–**	(20.0)
	2,828.6	2,477.2
Included in cash and cash equivalents	**–**	–

The movement in investment securities – available for sale excluding interest amounts is summarised as follows:

	2014	2013
At the beginning of the year	**2,461.6**	3,550.6
Acquisitions	**1,013.1**	1,501.0
Disposals and maturities	**(826.6)**	(2,456.3)
Exchange adjustments	**–**	(0.9)
Fair value movements through equity	**70.6**	(32.7)
Fair value movements through income or expense	**82.7**	(105.0)
Amortisation	**(8.9)**	(13.6)
Release and utilisation of impairment provision	**20.0**	18.5
At the end of the year	**2,812.5**	2,461.6

Notes to the Company financial statements continued
For the year ended 31 December 2014
All amounts are stated in £m unless otherwise indicated

7. Investment securities continued

Impairment analysis of investment securities – available for sale

	2014	2013
At the beginning of the year	**20.0**	39.0
Released during the year	**(1.1)**	–
Utilised during the year	**(18.9)**	(18.5)
Exchange adjustments	**–**	(0.5)
At the end of the year	**–**	20.0

c) Fair value through income or expense

	2014	2013
Fair value through income or expense		
Listed	**1,236.9**	1,743.4
	1,236.9	1,743.4
Less: allowance for losses	**–**	–
	1,236.9	1,743.4

The movement in investment securities – fair value through income or expense excluding interest amounts is summarised as follows:

	2014	2013
At the beginning of the year	**1,730.9**	1,830.6
Reclassified to fair value through income or expense	**–**	447.7
Acquisitions	**338.9**	2,120.9
Disposals and maturities	**(893.1)**	(2,632.9)
Exchange adjustments	**–**	(0.1)
Fair value movements through income or expense	**53.4**	(35.3)
At the end of the year	**1,230.1**	1,730.9

d) Analysis of investment securities by issuer

	2014	2013
Investment securities issued by public bodies:		
Government securities	**3,210.3**	3,064.3
Other public sector securities	**145.9**	560.5
	3,356.2	3,624.8
Investment securities issued by other issuers:		
Bank and building society certificates of deposits	**–**	–
Other debt securities:		
Other floating rate notes	**709.3**	595.8
Mortgage backed securities	**73.5**	83.1
	782.8	678.9
	4,139.0	4,303.7

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

Notes to the Company financial statements continued
For the year ended 31 December 2014
All amounts are stated in £m unless otherwise indicated

8. Derivative financial instruments

The Company has entered, as principal, into various derivatives either as a trading activity, which includes proprietary transactions and customer facilitation, or as a hedging activity for the management of interest rate risk, equity risk and foreign exchange rate risk. Positive and negative fair values have not been netted as the Company does not have a legal right of offset.

Derivatives held for trading purposes

The trading transactions are interest rate related contracts including swaps, caps and floors, forward rate agreements and exchange traded futures as well as equity swaps to manage equity risk. Trading transactions include derivatives where the Company enters into a transaction to accommodate a customer together with the corresponding hedge transaction. The Company no longer holds derivatives for proprietary trading purposes that do not relate to economic hedging activities.

Non-trading derivatives

Non-trading transactions comprise derivatives held for hedging purposes to manage the asset and liability positions of the Company. Derivatives used to manage interest rate related positions include swaps, caps and floors, forward rate agreements and exchange traded futures. The foreign exchange rate positions are managed using forward currency transactions and swaps. Equity risk is managed using equity swaps.

During the year the Company has entered into fair value hedges to mitigate price movements due to interest rate sensitivities.

	2014 Fair value		2013 (re-presented) Fair value	
	Assets	**Liabilities**	Assets	Liabilities
Derivatives held for non-trading purposes				
Derivatives designated as cash flow hedges:				
Interest rate swaps	**44.8**	**(16.7)**	37.9	(56.0)
Derivatives designated as fair value hedges:				
Interest rate swaps	**0.5**	**(341.1)**	52.5	(289.4)
Cross currency interest rate swaps	**4.8**	**(17.8)**	–	(1.5)
Derivatives held for non-trading purposes for which hedge accounting has not been applied:				
Interest rate swaps	**173.7**	**(150.6)**	124.6	(130.5)
Embedded derivatives – options	**–**	**–**	–	–
Forward currency transactions	**13.9**	**(68.1)**	7.5	(1.4)
OTC interest rate options	**0.9**	**(0.1)**	0.6	(2.2)
OTC equity options	**–**	**–**	0.3	–
Equity swaps	**50.9**	**(1.1)**	101.5	
Credit default swaps	**–**	**–**	–	(50.0)
Total derivative assets/(liabilities) held for non-trading purposes	**289.5**	**(595.5)**	324.9	(531.0)
Total recognised derivative assets/(liabilities)	**289.5**	**(595.5)**	324.9	(531.0)

2013 numbers have been re-presented to better reflect the derivatives analysis.

Refer to note 20 in the notes to the Bank financial statements for further information on derivatives held by the Bank.

Notes to the Company financial statements continued

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

9. Equity shares

	2014	2013
Investment securities		
Listed	**0.1**	0.1
Unlisted	**2.7**	5.7
	2.8	5.8
Included above are the following trade investments:		
VocaLink Holdings Limited – 4,416,165 ordinary shares of £1 each (2013: 4,416,165)	**2.7**	5.7

Equity shares are classified as available for sale.

10. Intangible fixed assets

	2014			2013		
	Internally generated intangible assets	**Other intangible assets**	**Total**	Internally generated intangible assets	Other intangible assets	Total
Cost						
At the beginning of the year restated	**451.4**	**46.0**	**497.4**	438.4	46.0	484.4
Additions	**36.2**	**–**	**36.2**	13.5	–	13.5
Disposals	**(8.8)**	**–**	**(8.8)**	(0.5)	–	(0.5)
Impairment	**(7.6)**	**–**	**(7.6)**	–	–	–
At the end of the year	**471.2**	**46.0**	**517.2**	451.4	46.0	497.4
Accumulated amortisation and impairment						
At the beginning of the year restated	**365.5**	**22.0**	**387.5**	206.8	15.5	222.3
Charge for the year	**21.8**	**4.5**	**26.3**	19.2	4.5	23.7
Disposals	**–**	**–**	**–**	(0.5)	–	(0.5)
Impairment	**–**	**–**	**–**	140.0	2.0	142.0
At the end of the year	**387.3**	**26.5**	**413.8**	365.5	22.0	387.5
Net book value						
At the end of the year	**83.9**	**19.5**	**103.4**	85.9	24.0	109.9
At the beginning of the year	85.9	24.0	109.9	231.6	30.5	262.1

Internally generated intangible assets consist of software development costs. Acquired computer software licences are capitalised on the basis of cost incurred to acquire and bring the software to use.

Other intangible assets consist of a core deposit intangible of £19.5m (2013: £24.0m).

Internally generated assets include £26.7m (2013: £8.5m) of assets in the course of construction.

The total impairment charge for the year is £nil (2013: £148.4m). In 2013, the charge was made up of impairment of internally generated intangible assets (£140.0m), other intangible assets (£2.0m) and assets in the course of construction not yet capitalised (£6.0m).

Notes to the Company financial statements continued

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

11. Investment properties

	2014	2013
Fair value		
At the beginning of the year	**1.9**	1.8
Additions – other expenditure	**–**	–
Disposals	**–**	–
Changes in fair value	**0.2**	0.1
At the end of the year	**2.1**	1.9

At the year end, investment properties relates solely to the Bank's stake in residential shared ownership properties. Shared ownership properties are carried at fair value, being the price at which the property could be exchanged between knowledgeable, willing parties in an arm's length transaction, measured under a combination of level 2 and level 3 of the fair value hierarchy (see Bank note 40). Fair value is calculated by using recent valuations of individual assets within the portfolio, indexed linked to the balance sheet date using the relevant regional house price index and the resulting profit/loss is recorded in the Bank's income statement.

12. Property, plant and equipment

2014	Land and buildings	Leasehold improvements	Computers and other equipment	Assets in the course of construction	Total
Cost					
At the beginning of the year	**34.2**	**25.1**	**138.2**	**13.7**	**211.2**
Additions	**–**	**–**	**17.9**	**7.6**	**25.5**
Disposals	**(2.1)**	**–**	**(10.1)**	**–**	**(12.2)**
Impairment	**–**	**–**	**–**	**(11.1)**	**(11.1)**
Transfers	**–**	**–**	**9.2**	**(9.2)**	**–**
Transfer to non-current assets held for sale (note 3)	**–**	**–**	**(13.1)**	**–**	**(13.1)**
At the end of the year	**32.1**	**25.1**	**142.1**	**1.0**	**200.3**
Accumulated depreciation					
At the beginning of the year	**4.4**	**22.5**	**104.4**	**–**	**131.3**
Charge for the year	**0.8**	**1.9**	**10.2**	**–**	**12.9**
Disposals	**(0.3)**	**–**	**(3.7)**	**–**	**(4.0)**
Impairment	**0.3**	**–**	**0.7**	**–**	**1.0**
Transfers	**–**	**–**	**–**	**–**	**–**
Transferred to non-current assets held for sale (note 3)	**–**	**–**	**(4.0)**	**–**	**(4.0)**
At the end of the year	**5.2**	**24.4**	**107.6**	**–**	**137.2**
Net book value					
At the end of the year	**26.9**	**0.7**	**34.5**	**1.0**	**63.1**
At the beginning of the year	29.8	2.6	33.8	13.7	79.9

Notes to the Company financial statements continued
For the year ended 31 December 2014
All amounts are stated in £m unless otherwise indicated

12. Property, plant and equipment continued

2013	Land and buildings	Leasehold improvements	Computers and other equipment	Assets in the course of construction	Total
Cost					
At the beginning of the year	34.5	25.1	149.4	16.1	225.1
Additions	–	–	6.5	6.8	13.3
Disposals	(0.3)	–	(16.1)	–	(16.4)
Impairment	–	–	(1.6)	(9.2)	(10.8)
At the end of the year	34.2	25.1	138.2	13.7	211.2
Accumulated depreciation					
At the beginning of the year	3.8	18.3	107.5	–	129.6
Charge for the year	0.8	4.2	10.4	–	15.4
Disposals	(0.2)	–	(14.0)	–	(14.2)
Impairment	–	–	0.5	–	0.5
At the end of the year	4.4	22.5	104.4	–	131.3
Net book value					
At the end of the year	29.8	2.6	33.8	13.7	79.9
At the beginning of the year	30.7	6.8	41.9	16.1	95.5

Included within the 2013 total assets, the Company did not hold legal title to £44.0m, but the Directors were of the opinion that the assets met the accounting criteria of an asset for the Company. The assets were therefore accounted for on the Company's balance sheet.

As part of the separation activity in November 2014, the Company purchased the legal title of all Company specific assets held by CFSMS (shared assets remained with CFSMS). The carrying value of these assets on the balance sheet at 31 December 2014 is £42.9m.

13. Other assets

	2014	Restated 2013
Amounts recoverable within one year:		
Trade debtors	**24.3**	29.7
Other assets	**60.1**	33.1
Amounts owed by The Co-operative Group	**58.9**	7.2
Amounts owed by The Co-operative Banking Group Limited	**–**	303.2
Amounts recoverable after more than one year:		
Amounts owed by The Co-operative Group	**78.3**	93.4
	221.6	466.6

Amounts owed by The Co-operative Group includes group relief recoverable of £101.3m (2013: £100.6m). Other assets include £60.1m (2013: £13.6m restated) of group relief recoverable from The Co-operative Bank undertakings.

Further details of the Company's related party transactions with The Co-operative Group are contained in note 25.

The 2013 comparatives have been restated as described in note 1.

Notes to the Company financial statements continued

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

14. Prepayments and accrued income

	2014	2013
Other:		
Amounts recoverable within one year	**5.8**	6.6
Amounts recoverable after more than one year	**6.0**	9.1
	11.8	15.7

15. Deposits by banks

	2014	2013
Items in course of collection	**37.9**	40.9
Deposits from other banks	**567.2**	2,822.4
	605.1	2,863.3

Included within deposits from other banks are liabilities of £280m (2013: £1,028.3m) secured on investment securities with a carrying value of £280m (2013: £1,004.4m).

16. Customer accounts – capital bonds

	2014	2013
Retail	**263.8**	527.3

Capital bonds are fixed term customer accounts with returns based on the movement in an index (eg FTSE 100) over the term of the bond. They have been designated on initial recognition at fair value through income and expense and are carried at fair value.

The fair values for the capital bonds are obtained on a monthly basis from the swap counterparties. These external valuations are reviewed independently using valuation software to ensure the fair values are priced on a consistent basis. None of the change in the fair value of the capital bonds is attributable to changes in the liability's credit risk.

The maximum amount the Bank would contractually be required to pay at maturity for all the capital bonds is £264.3m (2013: £539.2m).

The Bank uses swaps to create economic hedges against all of its capital bonds. The gain on capital bonds in the income statement for the year is £37.8m (2013: £21.3m). However, taking into account changes in fair value of the associated swaps, the net impact to the income statement for the year is a loss of £1.5m (2013: gain of £0.9m).

17. Debt securities in issue

	2014	Restated 2013
Certificates of deposit	**–**	5.1
Fixed and floating rate notes	**1,433.1**	1,498.8
	1,433.1	1,503.9

The Company has entered into cross currency interest rate swaps that protect it from changes in exchange rates and interest rates on its debt securities in issue. Changes in the fair values of these swaps are largely offset by changes in the sterling equivalent carrying value of the debt securities in issue.

The notes (covered bonds – secured, certificates of deposit and euro medium term notes – unsecured) require the Bank to repay contractual amounts due on specified maturity dates.

The 2013 comparatives have been restated as described in note 1.

Notes to the Company financial statements continued
For the year ended 31 December 2014
All amounts are stated in £m unless otherwise indicated

18. Other borrowed funds

	2014	2013
Fixed rate subordinated notes 2023	**206.0**	206.0
Issue costs, discounts and accrued interest	**(9.6)**	(9.7)
	196.4	196.3

Liability Management Exercise
On 20 December 2013, the Bank completed the Liability Management Exercise (LME). As a consequence of the LME, all perpetual subordinated bonds and other subordinated bonds then outstanding were cancelled and the preference shareholders rights to income and capital were waived. New fixed rate subordinated notes were issued on 20 December 2013 and are due to mature on 20 December 2023.

The notes are an unsecured obligation of the Bank admitted to trading on the London Stock Exchange. In the event of the winding up of the Bank, the claims of noteholders would be subordinated in right of payment to the claims of depositors and other creditors of the Bank. They carry an annual interest rate of 11% to maturity. Interest is payable quarterly in arrears.

19. Other liabilities

	2014	2013
Amounts falling due within one year:		
ATM creditor	**–**	20.1
Amounts owed to The Co-operative Banking Group	**126.0**	156.5
Other creditors	**22.8**	19.3
Amounts falling due after one year:		
Other creditors	**4.1**	4.6
	152.9	200.5

Other creditors of the Company include finance lease obligations as follows:

	Present value of lease payments		Future minimum lease payments	
	2014	2013	2014	2013
Due within one year	**–**	–	**–**	–
Due between one year and five years	**0.1**	0.1	**0.1**	0.1
Due after five years	**1.3**	1.3	**1.6**	1.6
	1.4	1.4	**1.7**	1.7

Further details of the Company's related party transactions with The Co-operative Banking Group are contained in note 25.

20. Accruals and deferred income

	2014	2013
Other:		
Amounts falling due within one year	**12.3**	51.9
Amounts falling due after one year	**–**	–
	12.3	51.9

Notes to the Company financial statements continued
For the year ended 31 December 2014
All amounts are stated in £m unless otherwise indicated

21. Provisions for liabilities and charges

2014	Property	FSCS levies	PPI	Conduct/ legal	Separation	Other	Total
At the beginning of the year	**21.6**	**13.2**	**133.8**	**222.6**	**39.4**	**30.6**	**461.2**
Provided/(released) in the year:							
net interest income	**–**	**–**	**–**	**48.0**	**–**	**–**	**48.0**
operating expense	**2.3**	**24.3**	**–**	**4.0**	**94.5**	**(3.1)**	**122.0**
other potential customer redress	**–**	**–**	**5.0**	**62.7**	**–**	**3.5**	**71.2**
Utilised during the year	**(0.5)**	**(24.9)**	**(65.2)**	**(38.3)**	**(21.6)**	**(21.4)**	**(171.9)**
Increase in discount on loans identified for disposal	**–**	**–**	**–**	**–**	**–**	**15.8**	**15.8**
At the end of the year	**23.4**	**12.6**	**73.6**	**299.0**	**112.3**	**25.4**	**546.3**
Provisions were analysed as follows:							
Amounts falling due within one year	**12.6**	**12.6**	**60.0**	**286.4**	**89.5**	**25.0**	**486.1**
Amounts falling due after one year	**10.8**	**–**	**13.6**	**12.6**	**22.8**	**0.4**	**60.2**
	23.4	**12.6**	**73.6**	**299.0**	**112.3**	**25.4**	**546.3**

2013	Property	FSCS levies	PPI	Conduct/ legal	Separation	Other	Total
At the beginning of the year (as restated)	7.2	12.1	116.0	–	–	–	135.3
Provided/(released) in the year:							
net interest income	–	–	–	104.5	–	–	104.5
operating expense	14.9	25.5	–	2.9	39.4	30.6	113.3
other potential customer redress	–	–	103.0	119.1	–	–	222.1
Utilised during the year	(0.5)	(24.4)	(85.2)	(3.9)	–	–	(114.0)
At the end of the year	21.6	13.2	133.8	222.6	39.4	30.6	461.2
Provisions were analysed as follows:							
Amounts falling due within one year	9.0	13.2	113.8	222.6	39.4	30.6	428.6
Amounts falling due after one year	12.6	–	20.0	–	–	–	32.6
	21.6	13.2	133.8	222.6	39.4	30.6	461.2

The Directors consider conduct and legal provisions a critical accounting judgement. Further details are provided in note 33 to the Bank financial statements.

Details of the Company's FSCS levy and PPI provision are as set out in note 33 to the Bank financial statements.

Property

The 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 has incurred dilapidations and/or the dilapidation clause within the contract has been invoked. During the year £2.3m (2013: £11.5m) has been provided for this.

Notes to the Company financial statements continued

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

21. Provisions for liabilities and charges continued

Conduct/legal provisions

During the year the Bank provided an additional £48.0m (2013: £104.5m) in respect of potential customer redress following identification of breaches of the Consumer Credit Act.

The £62.7m charged through potential customer redress consists of £37.0m in relation to arrears fees and charges and mortgage delivery costs, a £6.0m release in relation to mortgage documentation and a £31.7m increase in other conduct related provisions.

£4.0m has been provided through operating expenses relating to other conduct related provisions.

Other

The £91.4m charged through operating expenses consists of £94.5m relating to separation costs and a £3.1m release relating to other provisions.

During December 2014 the Company entered into a Sale and Purchase Agreement to dispose of a portfolio of performing loans not considered to be core assets to a third party. These assets will be derecognised in 2015 after the completion of the contract. A constructive obligation in respect of the discount on the loans identified for disposal of £13.0m has been recognised in 2014 (2013: £nil).

Details of the property provisions, FSCS levy and PPI provision are as set out in note 33 to the Bank financial statements.

22. Deferred tax

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

The movements on the deferred tax asset accounts are as follows:

	2014	Restated 2013
Deferred tax at the beginning of the year	**2.8**	138.8
(Charged)/credited to the income statement:		
Current year	**8.6**	(15.3)
Write off of prior year deferred tax asset	**–**	(136.4)
Prior year	**(0.2)**	3.1
	8.4	(148.6)
Credited/(charged) to other comprehensive income:		
Fair value unwinds	**–**	–
Cash flow hedges	**(8.7)**	12.5
Available for sale	**–**	0.1
	(8.7)	12.6
Deferred tax at the end of the year	**2.5**	2.8
Components of net deferred tax:		
Deferred tax asset	**14.6**	10.2
Deferred tax liability	**(12.1)**	(7.4)
	2.5	2.8

The deferred tax asset 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 £2.5m (2013: £2.8m restated).

Notes to the Company financial statements continued

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

22. Deferred tax continued

	2014	Restated 2013
Deferred tax comprises:		
Capital allowances on fixed assets and assets leased to customers	**14.6**	10.2
Cash flow hedges	**(11.5)**	(1.6)
Unrealised appreciation on investments	**(0.6)**	(0.6)
FSCS levy provision	**–**	(5.2)
	2.5	2.8

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

	2014	Restated 2013
Capital allowances on fixed assets and assets leased to customers	**(4.4)**	24.7
FSCS levy provision	**(5.2)**	5.2
Cash flow hedges	**1.2**	(1.4)
Fair value adjustments	**–**	65.6
Other temporary differences	**–**	1.7
Tax losses carried forward	**–**	51.9
Pensions and other post-retirement benefits	**–**	0.9
	(8.4)	148.6

Deferred tax assets totalling £292.9m (2013: £255.8m restated) have not been recognised where doubt exists over the availability of sufficient future taxable profits. Deferred tax has not been recognised in respect of trading losses of £1,229.2m (with deferred tax of £245.8m), capital losses of £16.4m (with deferred tax of £3.3m), and other temporary differences of £219.0m (with deferred tax of £43.8m). Deferred tax assets from the prior year of £nil (2013: £137.6m restated) have been written off in the year. Deferred tax assets of £22.3m (2013: £118.2m) in respect of the current year have not been recognised.

Reductions in the UK corporation tax rate from 23% to 21% (effective from 1 April 2014) and 20% (effective from 1 April 2015) were substantively enacted on 2 July 2013. This will reduce the Bank's future current tax charge accordingly. Deferred tax as at 31 December 2014 has been calculated based on the rate of 20% substantively enacted at the balance sheet date.

On 3 December 2014 the Chancellor of the Exchequer announced that the UK Government will introduce legislation in the Finance Bill 2015, which will restrict the proportion of banks' annual taxable profit that can be offset by certain carried forward tax losses. The restriction will take effect from 1 April 2015 and will apply to relevant tax losses arising prior to this date.

The Chancellor's announcements have not been enacted or substantively enacted at the balance sheet date and as the Company has not recognised a deferred tax asset on carried forward tax losses, there would be no impact on the tax balances in the financial statements for the year ended 31 December 2014. We will consider the impact of the final legislation once enacted.

Notes to the Company financial statements continued

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

23. Contingent liabilities and commitments

The tables below provide the contract amounts and risk weighted amounts of contingent liabilities and commitments. The contract 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 PRA 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.

		Unaudited		Unaudited
	Contract amount 2014	**Risk weighted amount 2014**	Contract amount 2013	Risk weighted amount 2013
Contingent liabilities:				
Guarantees and irrevocable letters of credit	**43.0**	**17.8**	86.1	45.2
Other commitments:				
Documentary credits and short term trade related transactions	**–**	**–**	0.8	0.2
Forward asset purchases and forward deposits placed[1]	**154.9**	**77.8**	650.5	168.1
Undrawn formal standby facilities, credit lines and other commitments to lend (includes revocable and irrevocable commitments)[2]	**2,543.5**	**384.7**	3,391.1	642.4
	2,741.4	**480.3**	4,128.5	855.9

1. Forward asset purchases have significantly reduced during the year due to repos maturing and there being lower funding requirements.
2. Undrawn loan commitments include revocable commitments which are unused credit card limits of £1,787.3m (2013: £1,968.1m).

Assets pledged

Assets are pledged as collateral under repurchase agreements with other banks. These deposits are not available to finance the Company's day-to-day operations. Mandatory reserve deposits are also held with the Bank of England in accordance with statutory requirements.

See note 27(d) in the Company financial statements for further details of assets pledged, and other contingent liabilities and commitments.

Commitments under operating leases

The Company leases various properties and equipment 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 Co-operative Bank plc remains in negotiations to enter into leases for the CIS Building in Manchester and these are expected to be finalised in quarter one 2015. The table below discloses the minimum operating lease payments the Company will be required to make over the remaining lives of the leases.

	Land and buildings 2014	**Equipment 2014**	Land and buildings 2013	Equipment 2013
Falling due:				
Within one year	**19.5**	**0.1**	19.6	–
Between one and five years	**46.5**	**0.3**	51.2	0.4
In five years or more	**51.5**	**–**	56.4	–
	117.5	**0.4**	127.2	0.4

The Company leases a number of branch and office premises 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 for the Company was £5.0m (2013: £8.0m).

Commitments to financially support subsidiary undertakings

Where relevant, the Company has committed to financially support certain subsidiary undertakings including consolidated structured entities.

Notes to the Company financial statements continued
For the year ended 31 December 2014
All amounts are stated in £m unless otherwise indicated

24. Investments in Co-operative Bank undertakings
Investments in equity shares and loans of subsidiary undertakings are financial assets.

	2014			2013		
	Ordinary shares	**Capital contributions**	**Total**	Ordinary shares	Capital contributions	Total
At the beginning of the year	**569.5**	**883.9**	**1,453.4**	569.5	1,239.0	1,808.5
Additions	**–**	**–**	**–**	–	–	–
Repayments	**(25.0)**	**(366.9)**	**(391.9)**	–	(355.1)	(355.1)
At the end of the year	**544.5**	**517.0**	**1,061.5**	569.5	883.9	1,453.4

Subsidiary undertakings
The Company has, except in the case of Unity Trust Bank plc, a direct interest in the ordinary share capital of the following principal subsidiary undertakings trading in the businesses indicated. All subsidiary undertakings are included in the Bank results.

Principal subsidiary undertakings which are registered in England and operating in the UK:

		% Shareholding 2014	% Shareholding 2013
Unity Trust Bank plc			
(held through subsidiary undertaking)	Banking	**27%**	27%
Co-operative Commercial Limited	Investment company	**100%**	100%
First Roodhill Leasing Limited	Leasing	**100%**	100%
Second Roodhill Leasing Limited	Leasing	**100%**	100%
Third Roodhill Leasing Limited	Leasing	**100%**	100%
Fourth Roodhill Leasing Limited	Leasing	**100%**	100%
Britannia Treasury Services Limited	Holding company	**100%**	100%
Britannia Asset Management Limited	Holding company	**100%**	100%
Britannia Development and Management Company Limited	Property investment	**100%**	100%
Illius Properties Limited	Property investment	**–**	100%
Moorland Covered Bonds LLP	Mortgage acquisition and guarantor of covered bonds	**100%**	100%
Southside Regeneration Limited	Property holding company	**100%**	100%

Unity Trust Bank plc is considered to be a subsidiary undertaking of The Co-operative Bank plc as The Co-operative Bank plc elects a majority of the Directors and appoints the Chair and the Managing Director. This provides the power to control. See note 38 of the Bank financial statements for details of the relationship with Unity Trust Bank plc.

Investments in equity shares and loans with subsidiary undertakings are shown net of impairments.

Illius Properties Limited was sold on 28 November 2014 for a cash consideration of £157.0m. A summary of the assets and liabilities of Illius Properties Limited at the point which the control was lost is provided below.

	28 November 2014
Cash and cash equivalents	**–**
Investment properties	**157.5**
Other liabilities	**(0.5)**

Notes to the Company financial statements continued

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

24. Investments in Co-operative Bank undertakings continued

Britannia Treasury Services Limited has the following principal wholly owned subsidiary undertakings, registered in England, operating in the UK and trading in the businesses indicated:

Mortgage Agency Services Number One Limited	Mortgage and syndicated lending
Mortgage Agency Services Number Two Limited	Mortgage lending
Mortgage Agency Services Number Four Limited	Mortgage lending
Mortgage Agency Services Number Five Limited	Mortgage lending
Mortgage Agency Services Number Six Limited	Mortgage lending
Western Mortgage Services Limited	Mortgage book administration
Platform Group Holdings Limited	Holding company

Platform Group Holdings Limited has the following principal wholly owned subsidiary undertakings, registered in England, operating in the UK and trading in the businesses indicated:

Platform Consumer Services Limited	Mortgage lending
Platform Funding Limited	Mortgage origination
Platform Home Loans Limited	Mortgage origination and servicing

Platform Consumer Services Limited is the only direct subsidiary of Platform Group Holdings Limited.

Registered in the Isle of Man and operating overseas:

Britannia International Limited	Deposit taking

On 10 January 2014, The Co-operative Bank plc announced that in line with its wider strategy of simplifying the business it is to wind down Britannia International operations. Operations have been gradually scaled down and customer accounts closed in an orderly manner throughout 2014. Any remaining customer accounts will be closed in 2015 and placed into a scheme to manage these funds. Full details of this scheme have been communicated to all affected customers.

It is the intention of Britannia International Limited Company to surrender its Class 1 Deposit-Taking Licence to the Isle of Man Financial Supervision Commission on 31 March 2015.

Registered in Scotland and operating in the UK:

Britannia Life Direct Limited	Direct sales of financial services

Southside Regeneration Limited and Western Mortgage Services Limited have been classified as held for sale as at 31 December 2014 as described in note 3 in the Company financial statements and note 15 in the Bank financial statements.

Notes to the Company financial statements continued

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

24. Investments in Co-operative Bank undertakings continued

Securitisation vehicles

The results of the following securitisation vehicles are consolidated into the results of the Bank:

Leek Finance Number Seventeen plc	Securitisation company
Leek Finance Number Eighteen plc	Securitisation company
Leek Finance Number Nineteen plc	Securitisation company
Leek Finance Number Twenty plc	Securitisation company
Leek Finance Number Twenty One plc	Securitisation company
Leek Finance Number Twenty Two plc	Securitisation company
Meerbrook Finance Number One Limited*	Securitisation company
Meerbrook Finance Number Two Limited*	Securitisation company
Meerbrook Finance Number Three Limited*	Securitisation company
Meerbrook Finance Number Four Limited	Securitisation company
Meerbrook Finance Number Eight Limited	Securitisation company
Silk Road Finance Number One plc	Securitisation company
Silk Road Finance Number Two plc	Securitisation company
Silk Road Finance Number Three plc	Securitisation company
Cambric Finance Number One plc	Securitisation company
Calico Finance Number One Limited	Securitisation company

* Dissolved on 3 February 2015.

All securitisation vehicles are registered in England and operate in the UK, with the exception of Calico Finance Number One Limited, which is registered and operates in the Republic of Ireland.

All of the above companies are related parties to the Company. See note 25 for the related party disclosures.

See note 40 to the Bank financial statements for further details of securitisation vehicles.

25. Related party transactions

Parent, subsidiary and ultimate controlling party

The ownership structure of the Company changed on 20 December 2013 as a result of the LME and as a result of a further share issue of £400m to existing shareholders in April 2014, The Co-operative Banking Group's share dropped to 20.16%. Further details are provided in note 4 of the Bank financial statements. As a result Co-operative Banking Group Limited now owns approximately 20% of the Company. The remaining, approximately 80%, is owned by a number of investors, none of which individually own more than 10%.

At 31 December 2014, the Company is an associate of, and therefore a related party of, The Co-operative Group as The Co-operative Group owns 20.16% of the Bank's ordinary shares, is entitled to Bank Board representation and there are material transactions between the two companies.

Transactions with CFS Management Services Limited

The Company has a significant relationship with CFS Management Services Limited (CFSMS). CFSMS is a subsidiary of the Co-operative Banking Group Limited and undertakes the provision of supplies and services to the Company. This relationship was in place for the whole of the year but will eventually be terminated after full separation is affected.

Further details of transactions with CFSMS are disclosed in note 38 to the Bank financial statements.

The Company has a significant relationship with The Co-operative Group. As part of the Recapitalisation Plan and in contemplation of the Company ceasing to be a wholly owned subsidiary of The Co-operative Group, the Bank entered into the agreements and several other arrangements with The Co-operative Group. Further details of the transactions with The Co-operative Group are disclosed in note 38 to the Bank financial statements.

Notes to the Company financial statements continued

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

25. Related party transactions continued

Balances with other Co-operative Group undertakings

Amounts owed by Co-operative Bank undertakings	2014	Restated 2013
Amounts owed by Co-operative Bank subsidiaries (excluding special purpose entities)	**6,489.8**	4,801.8
Amounts owed by Co-operative Bank subsidiaries – special purpose entities	**6,109.4**	7,085.0
	12,599.2	11,886.8

Amounts owed to Co-operative Bank undertakings	2014	Restated 2013
Amounts owed to Co-operative Bank subsidiaries (excluding special purpose entities)	**3,189.4**	2,047.8
Amounts owed to Co-operative Bank subsidiaries – special purpose entities	**2,843.6**	3,906.5
	6,033.0	5,954.3

Interest accrues on outstanding balances at a transfer price rate agreed between the Company and its subsidiaries.

In addition to the above balances with special purpose entities (SPEs), the Company holds floating rate notes in Leek Finance Number Seventeen plc of £14.5m (2013: £14.3m), in Leek Finance Number Eighteen plc of £20.1m (2013: £19.5m) and in Leek Finance Number Nineteen plc of £27.3m (2013: £23.6m) included within investment securities – available for sale.

The loans owed to the SPEs comprise cash balances deposited with the Company.

There are no formal repayment terms with subsidiary companies.

	2014			
	Loans and advances to customers	Other assets	Customer accounts	Other liabilities
The Co-operative Group	**51.0**	**101.5**	**(163.7)**	**–**
The Co-operative Banking Group Limited	**–**	**–**	**(55.5)**	**–**
Subsidiaries of the Co-operative Banking Group Limited	**–**	**35.7**	**(27.3)**	**(126.0)**
	51.0	**137.2**	**(246.5)**	**(126.0)**

	2013			
	Loans and advances to customers	Other assets	Customer accounts	Other liabilities
The Co-operative Group	110.1	100.6	(26.7)	–
The Co-operative Banking Group Limited	–	303.2	(49.6)	–
Subsidiaries of the Co-operative Banking Group Limited	–	–	(16.0)	(156.5)
	110.1	403.8	(92.3)	(156.5)

Notes to the Company financial statements continued

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

25. Related party transactions continued

The following tables show the value of transactions with The Co-operative Bank plc undertakings during the year.

2014	Interest and fees paid to Company	Interest and fees received from Company	Staff recharges paid to Company	Rent received from Company	Administration recharge paid to Company
Transactions with Co-operative Bank subsidiaries (excluding special purpose entities)	**60.8**	**8.2**	**7.6**	**0.6**	**7.7**
Transactions with Co-operative Bank subsidiaries – special purpose entities	**92.5**	**1.5**	**–**	**–**	**–**
2013					
Transactions with Co-operative Bank subsidiaries (excluding special purpose entities)	61.4	60.9	9.3	0.6	8.0
Transactions with Co-operative Bank subsidiaries – special purpose entities	112.2	105.5	–	–	–

Transactions with Directors, key management personnel and close family

Details of the Company's transactions with Directors, key management personnel and close family are as set out in note 38 to the Bank financial statements.

26. Share capital

	No. of shares (millions) 2014	Share capital 2014	No. of shares (millions) 2013	Share capital 2013
Allotted, called up and fully paid (ordinary shares of 5p each)				
At the beginning of the year	**250.0**	**12.5**	8,200	410.0
Shares cancelled	**–**	**–**	(8,200)	(410.0)
Issue of new ordinary shares	**200.5**	**10.0**	250	12.5
Issue of bonus shares	**1.0**	**0.1**	–	–
At the end of the year	**451.5**	**22.6**	250	12.5
Share premium account				
At the beginning of the year		**1,359.8**		8.8
Issue of new ordinary shares		**377.2**		1,351.0
Issue of bonus shares		**(0.1)**		–
At the end of the year		**1,736.9**		1,359.8

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

The number of ordinary shares in issue at 31 December 2014 was 451,456,510 (2013: 250,000,000). The ordinary shareholders have one vote for every share held.

See note 39 to the Bank financial statements for further details on share capital.

Notes to the Company financial statements continued

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

27. 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. As a wide range of valuation techniques are available, it may be inappropriate to compare this fair value information to that of independent market or other financial institutions.

The tables below analyse the balance sheet carrying values of financial assets and liabilities by classification.

Balance sheet categories	Held for trading	Designated at fair value	Loans and receivables	Available for sale	Liabilities at amortised cost	Derivatives in a hedging relationship	Total
2014							
Assets							
Cash and balances at central banks	–	–	4,765.3	–	–	–	4,765.3
Loans and advances to banks	–	–	670.1	–	–	–	670.1
Loans and advances to customers	3.9	171.4	15,800.9	–	–	–	15,976.2
Fair value adjustments for hedged risk	–	–	150.8	–	–	–	150.8
Investment securities	–	1,236.9	73.5	2,828.6	–	–	4,139.0
Derivative financial instruments	239.4	–	–	–	–	50.1	289.5
Equity shares	–	–	–	2.8	–	–	2.8
Amounts owed by other Co-operative Bank undertakings	–	–	12,599.2	–	–	–	12,599.2
Other assets	–	–	221.6	–	–	–	221.6
Total financial assets	243.3	1,408.3	34,281.4	2,831.4	–	50.1	38,814.5
Non-financial assets							1,576.9
Total assets							40,391.4
Liabilities							
Deposits by banks	–	–	–	–	605.1	–	605.1
Customer accounts	–	–	–	–	28,820.4	–	28,820.4
Customer accounts – capital bonds	–	263.8	–	–	–	–	263.8
Debt securities in issue	–	–	–	–	1,433.1	–	1,433.1
Derivative financial instruments	219.9	–	–	–	–	375.6	595.5
Other borrowed funds	–	–	–	–	196.4	–	196.4
Amounts owed to other Co-operative Bank undertakings	–	1,126.0	–	–	4,907.0	–	6,033.0
Other liabilities	–	–	–	–	146.0	–	146.0
Total financial liabilities	219.9	1,389.8	–	–	36,108.0	375.6	38,093.3
Non-financial liabilities							565.8
Total liabilities							38,659.1
Capital and reserves							1,732.3
Total liabilities and equity							40,391.4

IAS 39 requires derivative financial instruments that are not in a hedging relationship to be classified as ‘held for trading’, this definition differs from the definition of ‘derivatives held for trading purposes’ as shown in note 8.

Notes to the Company financial statements continued

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

27. Fair values of financial assets and liabilities continued

Balance sheet categories	Held for trading	Designated at fair value	Loans and receivables	Available for sale	Liabilities at amortised cost	Derivatives in a hedging relationship	Total
2013 restated[1]							
Assets							
Cash and balances at central banks	–	–	5,418.8	–	–	–	5,418.8
Loans and advances to banks	–	–	579.9	–	–	–	579.9
Loans and advances to customers	–	134.2	20,162.6	–	–	–	20,296.8
Fair value adjustments for hedged risk	–	–	106.3	–	–	–	106.3
Investment securities	–	1,743.4	83.1	2,477.2	–	–	4,303.7
Derivative financial instruments	234.5	–	–	–	–	90.4	324.9
Equity shares	–	–	–	5.8	–	–	5.8
Amounts owed by other Co-operative Bank undertakings	–	–	11,886.8	–	–	–	11,886.8
Other assets	–	–	466.6	–	–	–	466.6
Total financial assets	234.5	1,877.6	38,704.1	2,483.0	–	90.4	43,389.6
Non-financial assets							1,663.6
Total assets							45,053.2
Liabilities							
Deposits by banks	–	–	–	–	2,863.3	–	2,863.3
Customer accounts	–	–	–	–	31,185.9	–	31,185.9
Customer accounts – capital bonds	–	527.3	–	–	–	–	527.3
Debt securities in issue	–	–	–	–	1,503.9	–	1,503.9
Derivative financial instruments	184.0	–	–	–	–	347.0	531.0
Other borrowed funds	–	–	–	–	196.3	–	196.3
Amounts owed to other Co-operative Bank undertakings	–	1,466.4	–	–	4,487.9	–	5,954.3
Other liabilities	–	–	–	–	200.5	–	200.5
Total financial liabilities	184.0	1,993.7	–	–	40,437.8	347.0	42,962.5
Non-financial liabilities							517.5
Total liabilities							43,480.0
Capital and reserves							1,573.2
Total liabilities and equity							45,053.2

1. The 2013 comparatives have been restated as described in note 1.

Notes to the Company financial statements continued

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

27. Fair values of financial assets and liabilities continued

a) Use of financial instruments

Refer to note 40. a) in the Bank financial statements for details of the use of financial instruments by the Company.

b) Valuation of financial assets and liabilities at fair value

The following tables analyse financial assets and liabilities carried at fair value by the three level fair value hierarchy defined as follows:

- Level 1 – Quoted market prices in active markets
- Level 2 – Valuation techniques using observable inputs
- Level 3 – Valuation techniques using unobservable inputs

	Fair value at end of the reporting period using:			
2014	**Level 1**	**Level 2**	**Level 3**	**Total**
Non-derivative financial assets				
Held for trading:				
Loans and advances to customers	–	3.9	–	3.9
Designated at fair value:				
Loans and advances to customers	–	164.7	6.7	171.4
Investment securities	1,236.9	–	–	1,236.9
Available for sale financial assets:				
Investment securities	2,828.6	–	–	2,828.6
Equity shares	0.1	2.7	–	2.8
Derivative financial instruments	–	289.5	–	289.5
Non-financial instruments				
Investment properties	–	–	2.1	2.1
Total assets carried at fair value	**4,065.6**	**460.8**	**8.8**	**4,535.2**
Non-derivative financial liabilities				
Designated at fair value:				
Customer accounts – capital bonds	–	263.8	–	263.8
Amounts owed to other Co-operative Bank undertakings	–	–	1,126.0	1,126.0
Derivative financial instruments	–	595.5	–	595.5
Total liabilities carried at fair value	**–**	**859.3**	**1,126.0**	**1,985.3**

Notes to the Company financial statements continued

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

27. Fair values of financial assets and liabilities continued

	Fair value at end of the reporting period using:			
2013	Level 1	Level 2	Level 3	Total
Non-derivative financial assets				
Designated at fair value:				
Loans and advances to customers	–	125.5	8.7	134.2
Investment securities	1,743.4	–	–	1,743.4
Available for sale financial assets:				
Investment securities	2,477.2	–	–	2,477.2
Equity shares	0.1	5.7	–	5.8
Derivative financial instruments	–	314.3	10.6	324.9
Non-financial instruments				
Investment properties	–	–	1.9	1.9
Total assets carried at fair value	4,220.7	445.5	21.2	4,687.4
Non-derivative financial liabilities				
Designated at fair value:				
Customer accounts – capital bonds	–	527.3	–	527.3
Amounts owed to other Co-operative Bank undertakings	–	–	1,466.4	1,466.4
Derivative financial instruments	–	454.9	76.1	531.0
Total liabilities carried at fair value	–	982.2	1,542.5	2,524.7

Notes to the Company financial statements continued

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

27. Fair values of financial assets and liabilities continued

The carrying values of financial instruments measured at fair value are determined in compliance with the accounting policies on pages 154 to 168 and according to the following hierarchy:

Level 1 – Quoted market prices in active markets

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

Level 2 – Valuation techniques using observable inputs

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

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

Loans and advances to customers

Loans and advances to customers include corporate loans of £164.7m (2013: £125.5m) which are fair valued through income or expense using observable inputs. Loans held at fair value are valued at the sum of all future expected cash flows, discounted using a yield curve based on observable market inputs.

Investment securities – available for sale

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

Derivative financial instruments

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

Customer accounts – capital bonds

The estimated fair value of customer accounts – capital bonds is based on independent third party valuations using forecast future movements in the appropriate indices.

Equity shares

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

Level 3 – Valuation techniques using unobservable inputs

This is used for financial instruments valued using models where one or more significant inputs are not observable.

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

Loans and advances to customers

Loans and advances to customers include 25 year fixed rate mortgages of £6.7m (2013: £8.7m) which are fair valued through income or expense using unobservable inputs. 25 year fixed rate mortgages are valued using future interest cash flows at the fixed customer rate and estimated schedule of customer repayments. Cash flows are discounted at a credit adjusted discount rate; the credit adjustment is based on the average margin of new long dated (five years or greater) fixed rate business written in the last six months, and subject to quarterly review. The eventual timing of future cash flows may be different from that forecast due to unpredictable customer behaviour, particularly on a 25 year product. The valuation methodology takes account of credit risk and has decreased the valuation by £0.5m in 2014 (2013: £0.8m decrease). A reasonable change in the assumptions would not result in any material change in the valuation.

Notes to the Company financial statements continued

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

27. Fair values of financial assets and liabilities continued

Amounts owed to other Co-operative Bank undertakings

Amounts owed to Co-operative Bank undertakings are to the Silk Road Finance Number One plc (Silk Rd 1) subsidiary, relating to the legal transfer of loans and advances on securitisation. The amounts are fair valued to eliminate an accounting mismatch of the swap derivative as discussed below.

Revaluation of the £1,126m (2013: £1,466.4m) mortgage pool from carrying to fair value is based on assumed timing of future mortgage capital and revenue receipts, discounted to present value using a credit adjusted discount rate.

The amortisation profile is based on a redemption profile, assuming some annual prepayment, which is extended to the earlier of the mortgage maturity date or the step-up date, the earliest contractual maturity of the debt securities in issue when the balance outstanding on the notes may be repaid, this falls on 21 March 2015. Similarly, the revenue receipts are calculated based on the redemption profile, but extended until the earlier of the mortgage maturity date or the step-up date. For fixed rate mortgages, revenue receipts are based on fixed customer rates within the assumed amortisation profile. For tracker, SVR and discount products, revenue receipts are assumed to be based on forward Bank of England base rates plus the product margins. Fixed and tracker mortgages are assumed to revert to SVR at the end of any offer period. All mortgages in the mortgage pool were originated pre 31 December 2007.

Derivative financial instruments

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

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

The swaps are valued based on an assumed amortisation profile of the pool of assets to the bond maturity date (assuming some annual prepayment), an assumed profile of customer receipts over this period, and LIBOR prediction using forward rates. Swap cash flows are discounted to present value using mid-yield curve zero coupon rates, ie no adjustment is made for credit losses, nor for transaction or any other costs.

In addition derivative liabilities include a credit default swap. The credit default swap balance has arisen, as on 28 January 2013, the Company entered in to a transaction to transfer a mezzanine portion of the risk in a portfolio of residential mortgage loans to third party investors, via a special purpose vehicle, Calico Finance Number One Limited. The valuation takes on market MBS spreads, less the original traded spread multiplied by the notional, and the duration, then discounted. These spreads include the probability of default.

Investment properties

Investment properties are carried at fair value. Fair value is calculated using recent valuations of individual assets within the portfolio, indexed linked to the balance sheet date using the relevant regional house price index where appropriate.

Notes to the Company financial statements continued
For the year ended 31 December 2014
All amounts are stated in £m unless otherwise indicated

27. Fair values of financial assets and liabilities continued
Movements in fair values of instruments with significant unobservable inputs (level 3) were:

	Fair value at the beginning of the year	Purchases and transfers in	Sales and transfers out	Income or expense including impairment	Fair value at the end of the year
2014					
Loans and advances to customers	**8.7**	**–**	**(1.5)**	**(0.5)**	**6.7**
Derivative assets	**10.6**	**–**	**(10.6)**	**–**	**–**
Derivative liabilities	**(76.1)**	**–**	**76.1**	**–**	**–**
Amounts owed to other Co-operative Bank undertakings	**(1,466.4)**	**–**	**343.3**	**(2.9)**	**(1,126.0)**
Investment properties	**1.9**	**–**	**–**	**0.2**	**2.1**
	(1,521.3)	**–**	**407.3**	**(3.2)**	**(1,117.2)**
2013					
Loans and advances to customers	11.2	–	(1.7)	(0.8)	8.7
Derivative assets	10.9	–	(0.6)	0.3	10.6
Derivative liabilities	(12.9)	(58.2)	–	(5.0)	(76.1)
Amounts owed to other Co-operative Bank undertakings	(1,764.4)	–	299.7	(1.7)	(1,466.4)
Investment properties	1.8	–	–	0.1	1.9
	(1,753.4)	(58.2)	297.4	(7.1)	(1,521.3)

c) Fair values of financial assets and liabilities not carried at fair value
The carrying values of financial instruments measured at amortised cost are determined in compliance with the accounting policies on pages 154 to 168.

The table below sets out a summary of the carrying and fair values of:

- financial assets classified as loans and receivables; and
- financial liabilities classified as held at amortised cost,

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

	Carrying value	Fair value
2014		
Financial assets		
Loans and advances to banks	**670.1**	**670.1**
Loans and advances to customers	**15,800.9**	**15,655.8**
Fair value adjustments to hedged risk	**150.8**	**150.8**
Investments securities	**73.5**	**78.9**
Amounts owed by other Co-operative undertakings	**12,599.2**	**12,352.3**
Other assets	**221.6**	**221.6**
Financial liabilities		
Deposits by banks	**605.1**	**605.1**
Customer accounts	**28,820.4**	**28,809.1**
Debt securities in issue	**1,433.1**	**1,469.9**
Other borrowed funds	**196.4**	**223.2**
Amounts owed to other Co-operative undertakings	**4,907.0**	**4,934.1**
Other liabilities	**146.0**	**146.0**

Notes to the Company financial statements continued

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

27. Fair values of financial assets and liabilities continued

	Carrying value (restated)[1]	Fair value (restated)[1]	Fair value (apply 2014 Methodology)[2]
2013			
Financial assets			
Loans and advances to banks	579.9	579.9	579.9
Loans and advances to customers	20,162.6	18,707.0	19,505.7
Fair value adjustments to hedged risk	106.3	106.3	106.3
Investments securities	83.1	93.3	93.3
Amounts owed by other Co-operative undertakings	11,886.8	11,445.8	11,445.8
Other assets	466.6	466.6	466.6
Financial liabilities			
Deposits by banks	2,863.3	2,863.1	2,863.1
Customer accounts	31,185.9	31,210.9	31,210.9
Debt securities in issue	1,503.9	1,523.1	1,523.1
Other borrowed funds	196.3	234.2	234.2
Amounts owed to other Co-operative undertakings	4,487.9	4,486.7	4,486.7
Other liabilities	200.5	200.5	200.5

1. The 2013 comparatives have been restated as described in note 1.
2. In 2014, the Bank reviewed and improved the methods used to calculate the fair values of loans and advances to customers. The 2013 comparatives for loans and advances to customers have been recalculated accordingly to reflect these changes in methods.

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

Loans and advances to banks/deposits by banks

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

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

Loans and advances to customers

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

i. Retail

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

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

Notes to the Company financial statements continued

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

27. Fair values of financial assets and liabilities continued

ii. Corporate

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

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

Investment securities

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

Amounts owed by other Co-operative Bank undertakings

Amounts owed by other Co-operative Bank undertakings include debt securities and subordinated debt held in the Bank'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.

Customer accounts

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

Debt securities in issue and other borrowed funds

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

The fair value of debt securities in issue is significantly above the carrying value as a result of the carrying value being net of merger fair value adjustments. The carrying values of debt securities in issue are expected to increase as the merger fair value adjustments continue to unwind, by £149m in 2015, £180m in 2016 and by £59m in 2017.

Amounts owed to other Co-operative Bank undertakings

Amounts owed to other Co-operative Bank undertakings relate to deemed loans owed to the Bank's own securitisation vehicles, these have been modelled using expected cash flows, based on redemption profiles, discounted at a market rate.

Notes to the Company financial statements continued

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

27. Fair values of financial assets and liabilities continued

Fair values of financial assets and liabilities which are not carried at fair value and bases of valuation

Fair values are determined according to the hierarchy set out on page 272.

	Carrying value	Level 1	Level 2	Level 3
2014				
Financial assets				
Loans and receivables				
Loans and advances to banks	**670.1**	**–**	**670.1**	**–**
Loans and advances to customers	**15,800.9**	**–**	**–**	**15,655.8**
Fair value adjustment for hedged risk	**150.8**	**–**	**–**	**150.8**
Investment securities	**73.5**	**12.1**	**66.8**	**–**
Amounts owed by other Co-operative Bank undertakings	**12,599.2**	**–**	**5,203.3**	**7,149.0**
Financial liabilities				
Financial liabilities at amortised cost				
Deposits by banks	**605.1**	**–**	**605.1**	**–**
Customer accounts	**28,820.4**	**–**	**28,809.1**	**–**
Debt securities in issue	**1,433.1**	**789.1**	**680.8**	**–**
Other borrowed funds	**196.4**	**–**	**223.2**	**–**
Amounts owed to other Co-operative Bank undertakings	**4,907.0**	**–**	**–**	**4,934.1**

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

	Carrying value	Level 1	Level 2	Level 3
2013				
Financial assets				
Loans and receivables				
Loans and advances to banks	579.9	–	579.9	–
Loans and advances to customers	20,162.6	–	–	19,505.7
Fair value adjustment for hedged risk	106.3	–	–	106.3
Investment securities	83.1	21.5	71.8	–
Amounts owed by other Co-operative Bank undertakings	11,886.8	–	6,266.1	5,179.7
Financial liabilities				
Financial liabilities at amortised cost				
Deposits by banks	2,863.3	–	2,863.1	–
Customer accounts	31,185.9	–	31,210.9	–
Debt securities in issue	1,503.9	892.5	630.6	–
Other borrowed funds	196.3	–	234.2	–
Amounts owed to other Co-operative Bank undertakings	4,487.9	–	–	4,486.7

Notes to the Company financial statements continued

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

27. Fair values of financial assets and liabilities continued

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 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 position
2014					
Investments securities sold under repurchase agreements	**280.0**	**280.0**	**280.0**	**280.0**	**–**
Amounts owed by other Co-operative Bank undertakings sold under repurchase agreements	**1,141.9**	**500.3**	**744.2**	**500.3**	**243.9**

	Carrying amount of assets not derecognised	Carrying amount of associated liabilities	Fair value of assets not derecognised	Fair value of associated liabilities	Net position
2013					
Investments securities sold under repurchase agreements	1,004.4	1,028.3	1,022.5	1,028.3	(5.8)
Amounts owed by other Co-operative Bank undertakings sold under repurchase agreements	3,967.3	1,968.2	2,558.9	1,968.2	590.7

28. Company analysis of credit risk exposure

			Investment securities				
2014	Loans and advances to banks	Loans and advances to customers	Loans and receivables	Available for sale	Fair value through income or expense	Derivative financial liabilities	Total
Analysis of balance in note	**5**	**6**	**7**	**7**	**7**	**8**	
Gross balance	**670.1**	**16,644.9**	**73.5**	**2,828.6**	**1,236.9**	**289.5**	**21,743.5**
Less: allowance for losses	**–**	**(345.3)**	**–**	**–**	**–**	**–**	**(345.3)**
	670.1	**16,299.6**	**73.5**	**2,828.6**	**1,236.9**	**289.5**	**21,398.2**
Analysis of credit risk exposure							
Not impaired	**670.1**	**15,611.8**	**73.5**	**2,828.6**	**1,236.9**	**287.4**	**20,708.3**
Impaired	**–**	**1,033.1**	**–**	**–**	**–**	**2.1**	**1,035.2**
	670.1	**16,644.9**	**73.5**	**2,828.6**	**1,236.9**	**289.5**	**21,743.5**
Credit commitments	**154.9**	**2,585.8**	**–**	**–**	**–**	**–**	**2,740.7**
Gross credit risk exposure	**825.0**	**19,230.7**	**73.5**	**2,828.6**	**1,236.9**	**289.5**	**24,484.2**
Less allowances for losses	**–**	**(345.3)**	**–**	**–**	**–**	**–**	**(345.3)**
Net credit risk exposure	**825.0**	**18,885.4**	**73.5**	**2,828.6**	**1,236.9**	**289.5**	**24,138.9**

Notes to the Company financial statements continued

For the year ended 31 December 2014

All amounts are stated in £m unless otherwise indicated

28. Company analysis of credit risk exposure continued

			Investment securities				
2013	Loans and advances to banks	Loans and advances to customers	Loans and receivables	Available for sale	Fair value through income or expense	Derivative financial liabilities	Total
Analysis of balance in note	5	6	7	7	7	8	
Gross balance	579.9	20,975.2	83.1	2,497.2	1,743.4	324.9	26,203.7
Less: allowance for losses	–	(678.4)	–	(20.0)	–	–	(698.4)
	579.9	20,296.8	83.1	2,477.2	1,743.4	324.9	25,505.3
Analysis of credit risk exposure							
Not impaired	579.9	19,371.1	83.1	2,477.2	1,743.4	317.9	24,572.6
Impaired	–	1,604.1	–	20.0	–	7.0	1,631.1
	579.9	20,975.2	83.1	2,497.2	1,743.4	324.9	26,203.7
Credit commitments	650.5	3,519.8	–	–	–	–	4,170.3
Gross credit risk exposure	1,230.4	24,495.0	83.1	2,497.2	1,743.4	324.9	30,374.0
Less allowances for losses	–	(678.4)	–	(20.0)	–	–	(698.4)
Net credit risk exposure	1,230.4	23,816.6	83.1	2,477.2	1,743.4	324.9	29,675.6

Previously, the credit fair value adjustments have been disclosed separately in the above table; the table has now been revised to set off the credit fair value adjustments within the not impaired and impaired gross balances, to better show their gross carrying values in the Company.

The risk management disclosures on pages 85 to 130 apply to the Company where relevant and therefore no additional disclosures are included in this note.

29. Post balance sheet events

It is a requirement of IAS 10 (Events after the balance sheet date) that these financial statements reflect events arising after 31 December 2014. The following events have occurred between 31 December 2014 and 26 March 2015 (the date of approval of these financial statements) and represent 'non adjusting' post balance sheet events:

Migration of IT infrastructure

On 23 January 2015 the Bank entered into a contract with IBM to migrate its IT infrastructure from The Co-operative Group into IBM managed data centres. The Bank will pay IBM £93m to lead and implement the transition of these services to IBM data centres. The Bank has also entered into a 10 year managed service contract at a total cost of £275m and has options to terminate throughout the life of the contract.

Redemption of notes

On 9 March 2015, Leek Finance Number Twenty Limited and Leek Finance Number Twenty One Limited (subsidiaries of the Company) redeemed £1.4bn and £0.9bn of notes, respectively, representing their entire issued notes at that date measured at par plus accrued interest. These notes were 100% internally held by the Company as at 31 December 2014. The redemption did not result in a fair value adjustment write off for the Company.

Other information

Shareholder information

Registered office

1 Balloon Street
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Reg. No. 990937 (England)
Tel: 0161 832 3456
Fax: 0161 829 4475
Tel: 0870 702 0003

Registrar

Computershare Investor Services PLC
P.O. Box 82
The Pavilions
Bridgwater Road
Bristol BS99 7NH

Glossary

For the year ended 31 December 2014

The following glossary defines terminology used within the Bank's and Company's Annual Report and Accounts to assist the reader and to facilitate comparison with publications by other financial institutions:

Terminology	Definition
Almost prime	Almost prime lending is lending to borrowers with very low levels of adverse credit history.
Arrears	Customers are said to be in arrears or non-performing when they are behind in fulfilling their obligations with the result that an outstanding loan is unpaid or overdue. Corporate customers may also be considered non-performing prior to being behind in fulfilling their obligations. This can happen when a significant restructuring exercise begins.
Automated Valuation Model (AVM)	A valuation model used specifically for low loan to value (LTV) remortgages. Performance of AVMs is monitored on a regular basis to ensure their ongoing accuracy.
Banking Group	The Co-operative Banking Group Ltd and its subsidiaries, which included the Bank until legal separation occurred on 20 December 2013.
Basel II	A statement of best practice issued by the Basel Committee on Banking Supervision, that defines the methods by which firms should calculate their regulatory capital requirements to retain enough capital to protect the financial system against unexpected losses. Basel II became law in the EU Capital Requirements Directive, and was implemented in the UK via the FSA Handbook.
Basel III	A strengthening of the requirements laid out in Basel II, to be phased into the Bank from 2014 ahead of full implementation by 2022. Basel III is implemented within the European Union (including the UK) through CRD IV.
Basis points (bps)	One hundredth of a percent (0.01%), so 100 basis points is 1%. Used in quoting movements in interest rates or yields on securities.
BIPRU	The prudential sourcebook for banks, building societies and investment firms which sets out the PRA's requirements for capital and liquidity.
BaCB (Business and Commercial Banking)	The core segment of the Bank which specialises in lending to businesses.
Buy to let	A commercial practice of buying a property to let to tenants, rather than to live in.
Capital bonds	Fixed term customer accounts with returns based on the movement in an index (eg FTSE 100) over the term of the bond.
Capital ratio	Total of Tier 1 capital plus Tier 2 capital, all divided by Risk Weighted Assets.
Capital Requirements Directive (CRD IV)	This encompasses both the Capital Requirements Directive and Capital Requirements Regulation (CRR) as well as the PRA's Policy Statement PS7/13: Strengthening capital standards. CRD IV implements Basel III within the European Union (including the UK) and is a strengthening of the requirements laid out in Basel II.
Capital resources	Capital held, allowable under regulatory rules, less certain regulatory adjustments and deductions that are required to be made. Capital includes retained earnings, share premium and minority interests.
Carrying value	The value of an asset or liability as it appears in the balance sheet. For each asset or liability, the value is based on either of the amortised cost or fair value principles.
Certificates of deposit (CDs)	Debt issued by banks, savings and loan associations to individual investors with terms ranging from a few months to several years. Longer term CDs tend to bear a higher interest rate. At the expiration of the term, investors may (subject to penalties) withdraw both the principal and the accrued interest.
CFS Management Services Ltd (CFSMS)	CFS Management Services Ltd (CFSMS) provides supplies and services on behalf of subsidiary undertakings within The Co-operative Banking Group.
Charged off	When all economical avenues to recover an unsecured debt have been exhausted, the Bank permanently closes the loan account, ie it is charged off. This final step sits at the end of a time frame within which the Bank attempts to manage the debt's recovery and differs from a 'write down' in terms of its fixed position in time (see Write down).
Collateral	A borrower's pledge, usually a property, which acts as security for repayment of the loan (see Secured lending).
Collateralised swap	A swap, whose volatility is secured (collateralised) by way of exchanging cash deposits (see Swaps).
Colleague engagement	An internal survey, measuring the level of the Bank's employees' engagement.
Collectively assessed for impairment	Impairment is measured collectively where a portfolio comprises assets with a homogenous risk and, where appropriate, statistical techniques are available.
Commercial Paper	An unsecured promissory note issued to finance short term credit needs. It specifies the face amount paid to investors on the maturity date.
Commercial real estate	Commercial real estate includes office buildings, industrial property, malls, retail stores, shopping centres, multifamily housing buildings, warehouses, and industrial properties.

Glossary continued
For the year ended 31 December 2014

Terminology	Definition
Common Equity Tier 1	A CRD IV regulatory measure of financial (capital) strength. Common Equity Tier 1 capital is the highest quality of capital and comprises share capital and associated share premium, and general reserves from retained profits. The book values of goodwill and intangible assets as well as other regulatory adjustments, including the full amount of expected loss over provisions, are deducted from Common Equity Tier 1 capital for the purposes of capital adequacy.
Conduct risk	The risk that the Bank's behaviours, offerings or interactions will result in unfair outcomes for customers.
Contagion risk	An international financial market term which describes a corrupting or harmful influence, spreading effects of shocks from one counterparty to another.
Co-operative Asset Management (CoAM)	The segment that comprises Non-core assets managed for run down or exit.
Co-operative Banking Group (CBG)	The Co-operative Banking Group Ltd and its subsidiaries, which included the Bank until legal separation occurred on 20 December 2013.
Core business	Lines of business that are consistent with the Bank's strategy and risk appetite.
Corporate core segment	The segment that comprises corporate banking, business banking and business services in line with the Bank's strategy and risk appetite.
Cost of risk	Impairment charges (amounts provided for non-performing loans) expressed as a percentage of average loans during the year.
Cost to income ratio	Operating expenses divided by operating income.
Counterparty	In any financial contract, the person or institution entering the contract on the opposite side of the transaction is called a counterparty.
Covered bonds	Debt securities backed by a portfolio of mortgages that are segregated from the issuer's other assets solely for the benefit of the holders of the covered bonds. The Bank issues covered bonds as part of its funding activities.
Credit default swap	An arrangement whereby the credit risk of an asset (the reference asset) is transferred from the buyer to the seller of protection. A credit default swap is a contract where the protection seller receives premium or interest related payments in return for contracting to make payments to the protection buyer upon a defined credit event. Credit events normally include bankruptcy, payment default on a reference asset or assets, or downgrades by a credit rating agency.
Credit impairment	Impairment charges on loans and advances to customers.
Credit risk	The current or prospective risk to earnings and capital arising from a borrower's failure to meet the terms of any contract with the Bank or their failure to perform as agreed.
Credit valuation adjustments (CVAs)	Adjustments to the fair values of derivative assets to reflect the creditworthiness of the counterparty.
Currency swap	An arrangement in which two parties exchange specific principal amounts of different currencies at inception and subsequently interest payments on the principal amounts. Often one party will pay a fixed rate of interest, while the other will pay a floating rate (though there are also fixed-fixed and floating-floating arrangements). At the maturity of the swap, the principal amounts are usually re-exchanged.
Customer deposits	Money deposited by all individuals and companies that are not credit institutions. Such funds are recorded as liabilities in the Bank's balance sheet under customer accounts or financial liabilities designated at fair value.
Customer funding ratio	Customer deposits divided by customer loans. This is the reverse equation of the customer loan to deposit ratio (see Customer loan to deposit ratio).
Customer loan to deposit ratio	Customer loans divided by customer deposits. This is the reverse equation of the customer funding ratio (see Customer funding ratio).
Debt securities in issue	Transferable certificates of indebtedness of the Bank to the bearer of the certificates. These are liabilities of the Bank and include certificates of deposit, commercial paper and fixed and floating rate notes.
Default	Circumstances in which the probability of default is taken at 100% for the purposes of the calculation of regulatory capital and compliance with Basel II. This is defined as when a borrower reaches a predefined arrears status where a borrower is considered unlikely to repay the credit obligation in full without the lender taking action.
Deleverage the balance sheet	Strategic reduction of the Bank's risk asset base leading to improved capital management.
Delinquency	A customer in arrears is also said to be in a state of delinquency. When a customer is in arrears, his entire outstanding balance is said to be delinquent, meaning that delinquent balances are the total outstanding loans on which payments are overdue (see Arrears).
Derivative	A financial instrument that has a value, based on the expected future price movements of the instrument to which it is linked, such as a share or a currency.

Glossary continued
For the year ended 31 December 2014

Terminology	Definition
Effective interest rate method (EIR)	The method used to measure the carrying value of certain financial assets or liabilities and to allocate associated interest income or expense over the relevant period.
Encumbrance	Encumbrance is an impediment to use of assets, for example, a claim against a property by another party. Encumbrance usually impacts the transferability of the asset and restrict its free use until the encumbrance is removed.
Ethical Policy	A method developed since 1992 by which the Bank engages with its customers in relation to ethics.
Eurozone	The geographical area containing countries whose economies function using the European single currency.
Expected charge off rate	The expected level of a portfolio's loans that may be written off as bad debt.
Expected loss	A measure of anticipated loss for exposures captured under an internal ratings based credit risk approach. The expected loss amount is the exposure from a potential default of a counterparty or dilution over a one year period to the amount outstanding at default.
Exposure at default (EAD)	A Basel II Pillar I parameter the amount estimated to be outstanding at the time of default – EAD calculated under the standardised approach is always reported post credit conversion factors and provisions. Under the IRB approach the EAD includes undrawn commitments after credit conversion factors.
External audit	An independent opinion, by an external firm, on the Bank and Company's financial statements.
External credit rating	A financial indicator of risk, assigned by credit rating agencies to potential investors in the Bank.
Fair value adjustments	Fair value adjustments are the remaining balance sheet adjustments for the assets/liabilities acquired on the merger of the Bank and Britannia Building Society on 1 August 2009.
Fair value amortisation	The amortisation of the remaining interest risk related fair value adjustments for the assets/liabilities acquired on the merger of the Bank and Britannia Building Society on 1 August 2009 (see Interest rate risk).
Financial Conduct Authority (FCA)	The FSA was replaced as the UK's financial regulator on 1 April 2013 by two new regulatory bodies: the PRA and the FCA. The FCA is responsible for the regulation of conduct in retail, as well as wholesale, financial markets and the infrastructure that supports those markets.
Financial instruments	Any document with monetary value. Examples include cash and cash equivalents, but also securities such as bonds and stocks which have value and may be traded in exchange for money.
Financial Services Authority (FSA)	An independent non-governmental body, given statutory powers by the Financial Services and Markets Act 2000, which regulated the financial services industry. It was replaced as the UK's financial regulator on 1 April 2013 by the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA).
Financial Services Compensation Scheme (FSCS)	The UK's compensation fund of last resort for customers of authorised financial services firms. The FSCS may pay compensation to customers if a firm is unable, or likely to be unable, to pay claims against it, usually because it has stopped trading or has been declared in default. The FSCS is funded by the financial services industry. Every firm authorised by the PRA is obliged to pay an annual levy, which goes towards its running costs and compensation payments.
Floating rate notes (FRNs)	Investments with a variable interest rate. The adjustments to the interest rate are usually made every three to six months and are tied (or float) to a certain money market index.
Forbearance	The Bank, for reasons relating to the actual or apparent financial stress of a borrower, grants a concession whether temporarily or permanently to that borrower. A concession may involve restructuring the contractual terms of a debt (such as an extension of the maturity date or any weakening of the security structure or adjustment/non-enforcement of covenants) or payment in some form other than cash, such as an equity interest in the borrower.
Foreclosure	The legal process by which a lender, eg the Bank, obtains a court order in order to terminate a borrower's equitable right of redemption. This legal action is required when a borrower has materially failed to comply with the agreed terms and conditions of the loan, eg by defaulting (see Forbearance).
Forward rate agreement	A legal contract, governing the terms and conditions of a forward or future, in which the buyer pays a fixed rate of interest to the seller in return for the seller's floating rate (see Forwards, Futures and Swaps).
Forwards	Non-standardised contracts, traded Over-the-Counter, between two parties to buy or sell financial instruments at a specified future time at a price agreed today (see Over-the-Counter).
Funding for Lending	The Bank of England and HM Treasury launched the Funding for Lending Scheme (FLS) on 13 July 2012. It is designed to boost lending to households and businesses. It works by allowing participating banks and building societies to borrow from the Bank of England for up to four years. As security against that lending, participating banks will provide assets, such as business or mortgage loans, to the Bank of England. Banks will be able to borrow during the 18 months from 1 August 2012 until 31 January 2014.

Glossary continued
For the year ended 31 December 2014

Terminology	Definition
Futures	Standardised contracts, traded on an exchange, between two parties to buy or sell financial instruments at a specified future time at a price agreed today.
Gap	The Bank's net exposure to variable elements being managed within its market risk, eg interest rate movements (see Market risk).
Hedging	A technique used by the Bank to offset risks on one instrument by purchasing a second instrument that is expected to perform in the opposite way.
Impaired loans	Loans where the Bank does not expect to collect all the contractual cash flows or expects to collect them later than they are contractually due.
Impairment allowance	A loss allowance held on the balance sheet as a result of the raising of a charge against profit for the incurred loss inherent in the lending book. An impairment loss allowance may be either individual or collective.
Individual Capital Guidance (ICG)	The PRA's statement as to the regulatory capital, Pillar 2a, it expects the Bank to hold over Pillar 1.
Individual Liquidity Adequacy Assessment (ILAA)	The Bank's assessment of its liquidity risks, controls and quantification of liquid assets required to survive severe financial shocks through the use of stress tests prescribed by the PRA (see Liquidity risk).
Individual Liquidity Guidance (ILG)	A PRA guidance on the required amount and composition of the liquid assets buffer that should be held by a firm. This guidance arises once the firm's Individual Liquidity Adequacy Assessment (ILAA) has been conducted.
Individually assessed for impairment	Impairment is measured individually for assets that are individually significant.
Individually significant	Large value loans that exceed a balance threshold established by the Bank, above which it is deemed appropriate to impair accounts on an individual basis.
Interest rate risk	The variability in value borne by an interest bearing asset, such as a loan or a bond, due to variability of interest rates. In general, as rates rise, the price of a fixed rate bond will fall, and vice versa.
Internal audit	The examination of the Company's records and reports by its employees. Internal audits are usually intended to prevent fraud and to ensure compliance with Board directives and management policies.
Internal Capital Adequacy Assessment Process (ICAAP)	The Bank's own assessment, as part of Basel II requirements, of the levels of capital that it needs to hold in respect of its regulatory capital requirements (for credit, market and operational risks) and for other risks including stress events.
Internal Ratings Based (IRB) approach	A Basel II approach for measuring exposure to credit risks. IRB approaches are more sophisticated and risk sensitive than the Standardised Approach and may be Foundation or Advanced. IRB approaches may only be used with PRA permission.
Internal rating grade (IRG)	The grading of credit risk resulting from the Internal Ratings Based (IRB) approach.
Investment grade	A debt security, treasury bill or similar instrument with a credit rating measured by external agencies of AAA to BBB.
Legal separation	The process by which the Bank was legally separated from The Co-operative Group.
Leverage ratio	A CRD IV measure, calculated as the ratio of Tier 1 capital to total exposures. Total exposures include on-balance sheet items, off-balance sheet items and derivatives. The leverage ratio is a supplementary measure to the risk based capital requirements and is intended to constrain the build-up of excess leverage in the banking sector.
Liability Management Exercise (LME)	The process by which the Bank successfully raised c.£1.2bn of capital in 2013. This was effected by the transfer of preference shares and extinguishment of multiple subordinated liabilities, followed by the recognition of a single tranche of subordinated debt.
LIBOR (London Interbank Offered Rate)	The interest rate participating banks offer to other banks for loans on the London market.
Lifetime expected loss	The losses that the Bank expects to incur over the lifetime of portfolios of mortgage assets which were acquired on merger with Britannia Building Society. This is different from expected loss (see Expected loss) which is based on assets expected to default in the next 12 months.
Limited Liability Partnership (LLP)	An LLP provides each of its individual partners protection against personal liability for certain partnership liabilities.
Liquid Asset Buffer	A range of assets from which the Bank can manage its liquidity risk. These assets have relatively short maturity dates.
Liquidity and funding risk	The risk that the Bank's resources will prove inadequate to meet its liabilities as they contractually fall due or as a result of any contingent or discretionary cash outflows that may occur in times of stress. It arises from a mismatch of timings of cash flows generated from the Bank's assets and liabilities (including derivatives).
Loan to value (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).

Glossary continued
For the year ended 31 December 2014

Terminology	Definition
Loss emergence period	The time taken, expressed in months, for a loss event on a loan to become observed by the Bank.
Loss given default	An estimate of the actual loss that would occur in the event of default expressed as a percentage of the Exposure at Default (EAD).
Loss provisions	Provisions held against assets on the balance sheet as a result of the raising of a charge against profit for the incurred loss inherent in the lending book. The allowance represents management's best estimate of losses incurred in the loan portfolio at the balance sheet date.
Low to medium credit risk	Within not impaired, low to medium credit risk has been defined as exposures where the probability of default (PD) is 1% or below over a one year time horizon for exposures on an Internal Ratings Based (IRB) approach under Basel II, and slotting category strong/good for specialised lending exposures under the slotting approach (see Slotting).
Lower Tier 2	Lower Tier 2 capital comprises the Bank's long term subordinated debt.
Malus	A facility whereby the Remuneration Committee may reduce the amount of any deferred bonus payable in the event that any of the underpins to the incentive plans are not met or where business and/or individual performance otherwise requires.
Management expenses and compensation cost	The specific elements of both operating and financing cost which form the basis of the Financial Services Compensation Scheme (see Financial Services Compensation Scheme (FSCS)).
Mandatory reserve deposits	Mandatory reserve deposits are deposited with the Bank of England and are not available for use in the Bank's day-to-day operations. They are non-interest bearing and are not included in cash and cash equivalents.
Market risk	Risk that the values of assets and liabilities, earnings and/or capital may change as a result of changes in market prices of financial instruments. The majority of the Bank's market risk arises from changes in interest rates.
Medium term notes (MTN)	Flexible medium term corporate debt instruments, offered by the Bank to investors through a dealer. Investors can choose from differing maturities, ranging from nine months to 30 years.
Medium to high credit risk	Within not impaired, medium to high credit risk has been defined as a probability of default (PD) of greater than 1% over a one year time horizon for exposure on Internal Ratings Based (IRB) approach under Basel II, and slotting category weak/satisfactory for specialised lending exposures under the slotting approach (see Slotting).
Merger	Any combination of two or more business enterprises into a single enterprise. In the Bank, this specifically refers to the merger of the Bank with Britannia Building Society on 1 August 2009 (see Transfer of engagements).
Mortgage backed securities	Securities that represent interests in a group of mortgages. Investors in these securities have the right to cash received from future interest and/or principal mortgage payments.
Multilateral Development Banks (MDBs)	Supranational institutions which provide financial support and professional advice for economic and social development activities in developing countries. The term MDBs typically refers to the World Bank Group and Regional Development Banks.
Net interest income	The difference between interest received on assets and interest paid on liabilities after taking into account the effect of derivatives.
Net present value (NPV)	The present value of the expected future cash in and out flows on an asset or liability.
Non-conforming	Loans originated by Platform prior to 2009 and those acquired by Britannia Treasury Services, with similar risk profiles to Almost prime (see Almost prime).
Non-core business	Lines of business not congruent with the Bank's current strategy, are managed for value and are targeted for run down and exit, and contain the majority of impairment risk. Included in Non-core is Corporate Non-core business, Optimum (closed book of residential mortgages originated through intermediaries and previously purchased mortgage portfolios) and Illius (the residential property company).
Operational risk	The risk of loss resulting from inadequate or failed internal processes, people and systems or external events. This encompasses the effectiveness of risk management techniques and controls to minimise these losses.
Optimum	A sub-segment within CoAM which is a closed book of residential mortgages originated through intermediaries and previously purchased mortgage portfolios.
Options	Instruments which convey the rights, but not the obligations, to engage in future transactions.
Overnight Indexed Swap (OIS)	A rate reflecting the overnight interest typically earned or paid on the Bank's collateralised swaps. The OIS rate is used for valuing the discounted cash flows of collateralised swaps.
Over-the-Counter (OTC)	Contracts that are traded (and privately negotiated) directly between two parties, without going through an exchange or other intermediary. They offer flexibility because, unlike standardised exchange traded products, they can be tailored to fit specific needs.
Past due	When a counterparty has failed to make a payment when contractually due.

Glossary continued
For the year ended 31 December 2014

Terminology	Definition
Pension risk	The risk to Bank capital and Company funds from exposure to pension scheme liabilities and risks inherent in the valuation of scheme liabilities and assets.
Pillar 1	Minimum capital requirement under Capital Requirements Regulation.
Pillar 2a	PRA's guidance as to regulatory capital it expects a bank to hold above Pillar 1.
Preference shares	The preference shares are fixed interest shares, non-cumulative and irredeemable.
Prime	Prime mortgages are mainstream residential loans, which typically have a higher credit quality and fit standard underwriting processes. As such, they are likely to have a good credit history and pass a standard affordability assessment at the point of origination.
Probability of default (PD)	The likelihood that a loan will not be repaid and will fall into default. PD may be calculated for each customer who has a loan (normally applicable to wholesale customers) or for a portfolio of customers with similar attributes (normally applicable to retail customers). To calculate PD, the Bank assesses the credit quality of borrowers and other counterparties and assigns them an internal risk rating. Bonds with no maturity date that do not require the issuer to redeem.
Project Verde	The bid to purchase the Verde business from the Lloyds Banking Group. Also referred to as Project Mars.
Prudential Regulation Authority (PRA)	The FSA was replaced as the UK's financial regulator on 1 April 2013 with two new regulatory bodies: the PRA and the FCA. The PRA, a subsidiary of the Bank of England, is responsible for promoting the stable and prudent operation of the financial system through regulation of all deposit-taking institutions, insurers and investment banks.
Recapitalisation Plan	The process by which the Bank is improving its capital position in line with regulatory guidance.
Recovery and Resolution Plan	The FSA required all UK deposit takers and large investment firms to draw up a Recovery and Resolution Plan by 31 December 2012. The Recovery Plan assesses and documents the recovery options available in situations of financial stress or negative financial shocks, either market-wide or idiosyncratic. The Resolution Plan will provide authorities with sufficient information to enable them to determine a detailed roadmap to resolve a failed financial institution, without resorting to government (effectively taxpayer) support.
Remuneration Code	The Remuneration Code, issued by the Financial Services Authority, sets out the standards that banks, building societies and other financial institutions have to meet when setting pay and bonus awards for their staff. It aims to ensure that firms' remuneration practices are consistent with effective risk management.
Repo/Reverse repo	A repurchase agreement that allows a borrower to use a financial security as collateral for a cash loan at a fixed rate of interest. In a repo, the borrower agrees to sell a security to the lender subject to a commitment to repurchase the asset at a specified price on a given date. For the party selling the security (and agreeing to repurchase it in the future), it is a repo; for the party on the other end of the transaction (buying the security and agreeing to sell in the future), it is a reverse repurchase agreement or reverse repo.
Reputational risk	The risk associated with an issue which could in some way be damaging to the brand of the Bank either through its strategic decisions, business performance, an operational failure or external perception.
Retail segments	The Core and Non-core segments that comprise customer focused products and services for individuals, sole traders and small partnerships. This includes mortgages, credit cards, consumer loans, current accounts and savings products.
Return on Equity	The ratio of profit for the year (after tax) to shareholders equity, expressed as a percentage.
Return on Risk Weighted Exposure Amount (RRWEA)	The return on Bank's assets and exposures weighted according to risk. The measure is one of the performance metrics set by the Remuneration and Appointments Committee when assessing targets in the Long Term Incentive Plan.
Risk appetite	The articulation of the level of risk that the Bank is willing to accept (or not accept) in order to safeguard the interests of the members whilst achieving its business objectives.
Risk weighted amount	Risk weightings are established in accordance with Basel II as implemented by the FSA. Risk weighted amounts are the carrying value of the Bank's assets, adjusted by the risk weightings, to reflect the degrees of risk they represent.
Risk Weighted Assets	A measure of a bank's assets adjusted for their associated risks. Risk weightings are established in accordance with Basel II.
Secondary sovereign exposure	Direct exposure to something other than sovereign debt that has itself a direct exposure to sovereign debt.
Secured lending	Lending in which the borrower pledges retail or commercial property as collateral for the loan, which then becomes a secured debt owed to the Bank. In the event that the borrower defaults, the Bank may take possession of the asset used as collateral and may sell it to regain some or the entire amount originally lent to the borrower.

Glossary continued
For the year ended 31 December 2014

Terminology	Definition
Securitisation	A process by which a portfolio of retail mortgages is used to back the issuance of new securities by an SPE. The Bank has established securitisation structures as part of its funding and capital management activities (see Special purpose entities (SPEs)).
Senior unsecured debt	Debt that has priority ahead of all other unsecured or subordinated debt for payment in the event of default.
Slotting	The regulatory defined approach used for rating the risk level of Corporate lending using a broad scope of financial, political and transactional factors. The regulatory slotting categories are listed as follows: • 'Standardised' businesses lack sufficient information upon which detailed credit analysis can be undertaken for which models have yet to be developed; • 'Strong' businesses have little competition, high demand, significant governmental support and enforceable collateral; • 'Good' businesses have limited competition, stable demand, good governmental support and enforceable collateral; • 'Satisfactory' businesses have a broad competition base with limited levels of demand, governmental support and collateral; • 'Weak' businesses operate at a disadvantage to competition, display a declining trend of demand, with no governmental support and no clear collateral; and • 'Default' businesses are considered unlikely to repay their credit obligations (see Impaired loans).
SME customers	Small and medium sized businesses engaging with the Bank as customers.
SONIA	Sterling OverNight Index Average (SONIA). Yield curves used by the Bank for swap arrangements. These are based on overnight indexed rates.
Sovereign debt	Bonds issued by and loans given to central banks and local governments, governmental bodies and other government-related bodies.
Sovereign exposure	The Bank's exposure to the total financial obligations incurred by all governmental bodies of any nation.
Special purpose entities (SPEs)	Entities that are created to accomplish a narrow and well-defined objective. For the Bank this includes: various securitisation transactions in which mortgages were sold to SPEs; the equity of these SPEs is not owned by the Bank; and Covered Bond Limited Liability Partnerships created in order to act as guarantors for issues of covered bonds.
Specialised lending	Lending in which the primary source of repayment of the obligation is the income generated by the assets being financed, rather than the independent capacity of a broader commercial enterprise.
Standardised category	Customers who have not defaulted, and for the purposes of the capital calculations are not rated with the regulatory approved rating model.
Standard Variable Rate (SVR)	A variable and basic rate of interest charged on a mortgage. This may change in reaction to market conditions resulting in monthly repayments going up or down.
Statutory loss	The loss stated in accordance with the requirements of the UK Companies Act 2006, which incorporates the requirements of International Financial Reporting Standards (IFRS).
Strategic Asset Review	The process by which the Bank centrally monitors risk on its corporate loan assets in line with agreed strategy and governance parameters.
Strategic and business risk	Risk arising from changes to the Bank's business and the environment in which it operates, specifically the risk of not being able to carry out the Bank's business plan and desired strategy.
Subordinated debt/liabilities	Liabilities which, in the event of insolvency or liquidation of the Bank, are subordinated to the claims of depositors and other creditors of the Bank.
Swaps	An agreement between the Bank and a counterparty in which one stream of future payments is exchanged for another stream, based on a specified principal amount. For example, interest rate swaps often involve exchanging a fixed receipt for a floating receipt, which is linked to an interest rate (most often LIBOR). The Bank's use of swaps helps to manage periodic market risk on its financial instruments.
Term deposit	A deposit balance that cannot be withdrawn before a date specified at the time of deposit.
the Bank	The Co-operative Bank and its subsidiaries.
the Banking Group	See 'The Co-operative Banking Group'.
the Board	The Board of Directors. They manage the Bank's business performance in line with its purpose, givens, vision and values.

Glossary continued
For the year ended 31 December 2014

Terminology	Definition
the Company	The Co-operative Bank as a standalone entity.
The Co-operative Banking Group	The Co-operative Banking Group Ltd and its subsidiaries, which included the Bank until legal separation occurred on 20 December 2013.
The Co-operative Group	The former ultimate parent company of the Bank, pre legal separation.
Tier 1	A regulatory measure of financial (capital) strength. Tier 1 is divided into Core Tier 1 and other Tier 1 capital. Core Tier 1 capital comprises share capital and associated share premium, and general reserves from retained profits. The book values of goodwill and intangible assets are deducted from Core Tier 1 capital and other regulatory adjustments may be made for the purposes of capital adequacy. Qualifying capital instruments such as perpetual subordinated bonds are included in other Tier 1 capital.
Tier 1 ratio	Tier 1 capital divided by Risk Weighted Assets.
Tier 2	Tier 2 capital comprises the Bank's property valuation reserve, preference shares, qualifying subordinated notes and collective impairment allowance (for exposures treated on a Basel II standardised basis). Certain regulatory deductions may be made for the purposes of assessing capital adequacy.
Transfer of engagements	On 1 August 2009, Britannia Building Society merged with The Co-operative Bank plc by a transfer of engagements between the building society and the Bank under the Building Societies (Funding) and Mutual Societies (Transfers) Act 2007 (see Merger).
Treasury segment	The treasury segment's responsibilities usually include capital management, risk management, strategic planning and investor relations.
Unaudited	Financial information that has not been subjected to the audit procedures undertaken by the Bank's external auditor.
Unfunded pension scheme	Pension scheme which has liabilities and no assets. The Bank will pay the liabilities of the scheme as they fall due.
Unsecured lending	Lending for which there is no collateral for the loan.
Verde business	Separated part of the Retail business of the Lloyds Banking Group.
Value at risk (VaR)	VaR measures the daily maximum potential gain or loss due to market volatility within a statistical confidence level of 95% and a one day holding period. The VaR methodology employed is historical simulation using a time series of one year to latest day.
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	Wholesale banking is the provision of loans to corporate customers and institutional customers and services to other banks and financial institutions.
Write down	After an advance has been identified as impaired and is subject to an impairment allowance, the stage may be reached whereby it is concluded that there is no realistic prospect of further recovery. Write downs will occur when, and to the extent that, the whole or part of a debt is considered irrecoverable. This action can occur at any time in the debt's life (see Charged off).

Forward-looking statements

Certain terms

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

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

Unless otherwise stated, the income statement analyses and compares the 12 months to 31 December 2014 to the corresponding 12 months of 2013 and balance sheet comparisons, related to the corresponding position as at 31 December 2013. Unless otherwise stated, all disclosed figures relate to continuing operations. Relevant terms that are used in this document but are not defined under applicable regulatory guidance or International Financial Reporting Standards (IFRS) are explained in non-IFRS measures below.

Non-IFRS measures

Certain non-IFRS measures are provided within the Annual Report and Accounts. These can be found mainly (but not exclusively) on the Detailed Financial Review and the Detailed Key Performance Indicators pages.

Restatement

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

Forward-looking statements

This document contains certain forward-looking statements with respect to certain of the Bank's strategy, plans and its current goals and expectations relating to its future financial condition and operating performance. The Bank cautions readers that no forward-looking statement is a guarantee of future performance and that actual results could differ materially from those contained in the forward-looking statements. These forward-looking statements can be identified by the fact that they do not relate only to historical or current facts. Forward-looking statements sometimes use words such as 'may', 'will', 'seek', 'continue', 'aim', 'anticipate', 'target', 'projected', 'expect', 'estimate', 'intend', 'plan', 'goal', 'believe', 'achieve', 'predict', 'should' or in each case, their negative or other variations or comparable terminology, or by discussion of strategy, plans, objectives, goals, future events or intentions. These forward-looking statements include all matters that are not historical facts. Examples of forward-looking statements include, among others, statements regarding the Bank's future financial position, income growth, assets, impairment charges, business strategy, capital ratios, leverage, payment of dividends, the industry in which the Bank operates, projected costs, commitments in connection with the plan and the Bank's 4–5 year turnaround, estimates of capital expenditures and plans and objectives for future operations and other statements that are not historical fact.

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

Readers are advised to read, in particular, the Principal Risks and Uncertainties section in the Strategic Report starting on page 26 for a summary of factors that could affect the Bank's future performance. In light of these risks, uncertainties and assumptions, the events and targets described in the forward-looking statements in this document may not occur.

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

Appendix 1
EDTF recommendations
For the year ended 31 December 2014

Type of risk	Recommendation	Disclosure	Section in Pillar III	Section in risk management	Other sections of the accounts
General	1	Risks to which the business is exposed	5	Principal Risk	Strategic review
	2	Definition of risk terminology, principles and appetite	3, 5	Risk Appetite	
	3	Top and emerging risks and the changes during the reporting period	5	Principal risk profile	
	4	Analysis of future regulatory developments affecting our business model and the Bank's profitability	5		
Risk governance and risk management	5	The Bank's risk management organisation, process and key functions	3	Risk Management Framework	Strategic review
	6	Risk culture and risk governance and ownership	3		
	7	Key risks, risk appetite and risk management	3, 5		
	8	Stress testing and the underlying assumptions	4		Capital management
Capital adequacy	9	Minimum Pillar 3 disclosure requirements	4		Capital management
	10	Reconciliation of accounting balance sheet to regulatory balance sheet	4		
	11	Flow statement of movements in regulatory capital since the previous reporting period including changes in Common Equity Tier 1, Tier 1 and Tier 2 Capital	4		
	12	Discussion of targeted level of capital and how this will be established	1, 4, 5		
	13	Analysis of Risk Weighted Assets	4		
	14	Analysis of capital requirements for each Basel asset class	4		
	15	Analysis of credit risk for each Basel asset class	4		
	16	Flow statements reconciling the movements in Risk Weighted Assets for each Risk Weighted Asset type	4		Capital management
	17	Discussion of Basel credit risk model performance	5		
Liquidity and funding	18	Analysis of the Bank's liquid asset buffer	4	Liquidity risk 2.3.1	Note 40: Fair values of financial assets and liabilities
	19	Encumbered and unencumbered assets analysed by balance sheet category		Liquidity risk 2.5	
	20	Consolidated total assets, liabilities and off-balance sheet commitments analysed by remaining contract maturity at the balance sheet date		Liquidity risk 2.4	
	21	Analysis of the Bank's sources of funding		Liquidity risk 2.3.2	
Market risk	22	Relationship between the market risk measures for trading and non-trading portfolios and the balance sheet	5	Market risk 3.1	
	23	Discussion of trading significant trading and non-trading market risk factors	5	Market risk 3.1	
	24	VaR assumptions, limitations and validation	5	Market risk 3.4	
	25	Description of the primary risk management techniques employed by the Bank	5	Market risk 3.2	
Credit risk	26	Analysis of the aggregate credit risk exposures	5	Credit risk 1.2, 1.3, 1.4	Note 18: loans and advances to customers
	27	Describe the policies for identifying impaired and non-performing loans	5	Credit risk 1.3	
	28	Reconciliation of the opening and closing balances of non-performing or impaired loans in the period	5	Credit risk 1.3	
	29	Analysis of counterparty credit risk that arises from derivative transactions	5	Credit risk 1.3.4	
	30	Discussion of credit risk mitigation, including collateral held for all sources of risk	5	Credit risk 1.3	
Other risks	31	Description of other risks	5	Other risks 4–10	Note 33: Provisions for liabilities and charges Note 36: Contingent liabilities
	32	Discussion of publicly known risk events	5		

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Design by Radley Yeldar

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