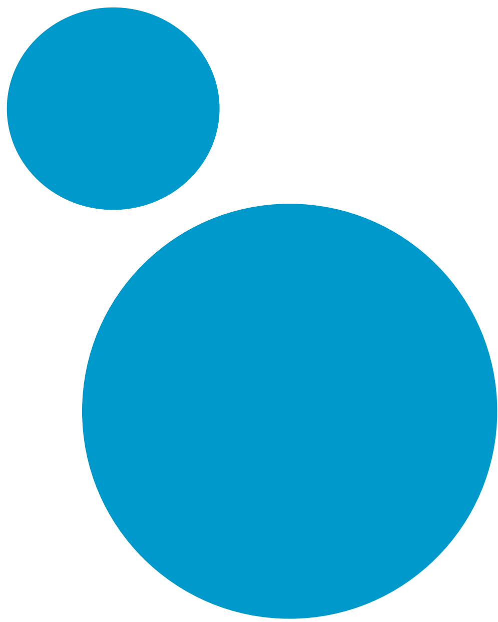
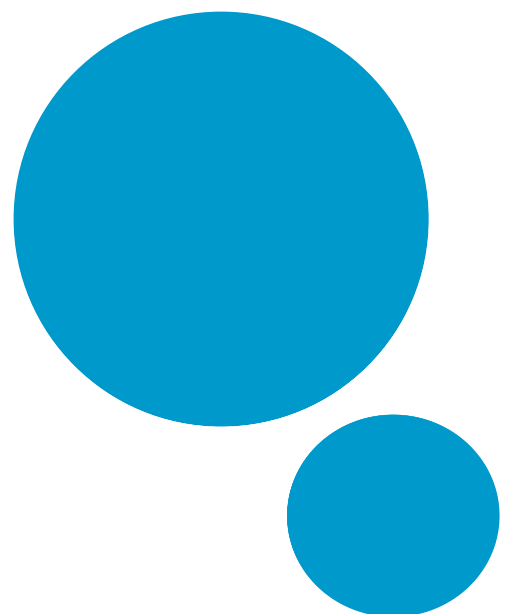


The Co-operative Bank plc

Annual Report and Accounts 2016



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The glossary for this document can be found at http://www.co-operativebank.co.uk/investorrelations/financialresults

Key Performance Indicators

KEY PERFORMANCE INDICATORS

The Key Performance Indicators presented below[1] reflect the way in which the performance of the Bank was measured in 2016. As the Bank continues to implement its turnaround, management will continue to review these measures.

	2016	2015	Change	Notes
Total Bank				
Statutory (loss) before tax (£m)	**(477.1)**	(610.6)	133.5	The Bank's loss before tax in 2016 continued to be impacted by legacy issues. Adverse impacts include the reduction in net interest income, an increase in the fair value amortisation associated with the merger with the Britannia Building Society and higher remediation and strategic project costs. Favourable impacts partially offsetting this are: reduced operating costs, lower losses on asset sales, a gain recorded from the sale of the Visa Europe share and lower conduct charges.
Net interest margin[2] (%)	**1.39**	1.42	(0.03)	Small decrease in net interest margin impacted by competitive pressures on new asset margins and the reduction in Bank of England base rate.
Cost:income ratio[3] (%)	**103.7**	100.0	3.7	Cost:income ratio increased as reductions in operating expenditure and operational project expenditure were more than offset by the reduction in interest income.
Common Equity Tier 1 (CET1) ratio (%)	**11.0**	15.5	(4.5)	CET1 ratio has decreased primarily as a result of the statutory loss after tax.
Leverage ratio (%)	**2.6**	3.8	(1.2)	Statutory losses have reduced Tier 1 capital at a greater rate than the balance sheet has been deleveraged.
Total RWAs (£bn)	**6.7**	7.4	(0.7)	Total RWAs have reduced in line with Non-core deleverage partially offset by growth in Core customer assets.
Total capital (%)	**17.7**	21.6	(3.9)	Total capital ratio has decreased reflecting the reduction in CET1 capital.
Colleague engagement (%)	**64.0**	66.0	(2.0)	Colleague engagement remains broadly stable as we continue our cultural change programme.
Core Bank				
Customer deposits(£bn)	**22.1**	22.4	(0.3)	Retail and BaCB deposits.
Customer assets (£bn)	**15.3**	14.7	0.6	
Credit RWAs (£bn)	**3.9**	3.7	0.2	
Total Current Account Holders	**1,435,470**	1,431,323	4,147	
Prime Current Account Holders	**664,268**	655,965	8,303	
Net interest margin[2] (%)	**1.78**	1.89	(0.11)	
Non-core Bank				
Customer assets (£bn)	**4.1**	4.9	(0.8)	
Credit RWAs (£bn)	**2.0**	2.8	(0.8)	

1. KPIs are calculated on a management accounts basis as this is how we manage our business.
2. Net interest margin is calculated as net interest income divided by the average of the opening and closing asset balances for the period.
3. Operating expenditure and operational projects (including associated depreciation and amortisation) divided by operating income excluding losses on assets sales.

Please see 'Detailed Key Performance Indicators' on page 32 for explanations of why these metrics are important and how they are calculated.

BANK PERFORMANCE – KEY HIGHLIGHTS AND OUTLOOK

Statutory loss before taxation, still impacted by legacy issues, has reduced to £477.1m in 2016 compared to a loss before tax of £610.6m in 2015

- Adverse impacts include a reduction in net interest income, an increase in the fair value amortisation associated with the merger with the Britannia Building Society and higher remediation and strategic project costs.

- Favourable impacts partially offsetting these adverse movements were: reduced operating costs, lower losses on asset sales, a gain recorded from the sale of the Visa Europe share and lower conduct charges.

- Net interest income decreased by £76.7m to £394.8m (2015: £471.5m) as a result of lower Non-core asset balances, new business asset spreads remaining under pressure due to strong competition in the mortgage market and to a lesser extent, the impact of the reduction in the Bank of England base rate.

- Conduct and legal risk charges reduced by £168.8m to £24.9m as the conduct remediation programme has substantially completed. The main driver of the charge in 2016 relates to £36.0m for PPI, which was partially offset by other provision releases.

- Remediation and strategic project costs increased to £275.6m in 2016 (2015: £216.2m), reflecting the transformation required to address the historic under investment in systems and processes. This includes £81.9m expensed in connection with the mortgage outsourcing programme, of which £48.5m relates to assets no longer expected to be in use.

- Fair value amortisation associated with the merger with the Britannia Building Society increased by £60.1m in 2016 to £180.5m (2015: £120.4m), representing 38% of the loss before taxation.

- The Bank's Common Equity Tier 1 (CET1) ratio stood at 11.0% at 31 December 2016 (31 December 2015: 15.5%) reflecting a reduction in Risk Weighted Assets (RWAs) of £0.7bn and a statutory loss after tax of £418.7m.

Simplifying of the business and reducing underlying costs continues

- Total operating costs reduced by £47.1m to £444.8m (2015: £491.9m), due to headcount reductions, further rationalisation of the branch network and lower third party costs.

- Operating staff costs have decreased year on year by £30.3m to £187.7m (2015: £218.0m). FTEs (including contractors) have fallen by 809 from 4,704 to 3,895.

- 59 branch closures completed in 2016, reducing the network to 105 branches.

- Successful migration of the Bank's core mainframe system to the new IBM managed environment completed in February 2017.

Rebuild of the retail franchise is gaining traction

- Mortgage originations continued to increase with completions totalling £3.1bn in 2016 (2015: £2.8bn), whilst redemptions (excluding contractual repayments) fell to £1.7bn (2015: £2.3bn). Our intermediary channel Platform accounted for 91% of completions and was voted Intermediary Lender of the Year for the second year running at the Your Mortgage awards.

- The Retail mortgage book grew by 5% to £14.1bn (2015: £13.4bn), representing 1.1% market share.

- Following the launch of our new Everyday Rewards current account, the number of prime current account holders increased by 8,303 to 664,268 (2015: 655,965).

- Customer relationship metrics across the Bank remain strong. The Bank's current account Net Promoter Score (NPS) was 17 at the end of 2016. The Bank ranked #4 in current account NPS which emphasises the strong service levels being delivered in contact centres and branches alongside continued improvement in digital channels and customer satisfaction ratings. The Bank has moved back into the Top 50 brands for customer service, climbing 46 places from 2015.

- New and improved online banking platform launched in May 2016.

- An upgraded mobile app was released in September 2016 and Apple Pay was launched in October 2016.

Continue building differentiated proposition on the expanded Ethical Policy

- New rewards based current account proposition, Everyday Rewards launched in January 2016.

- Return to campaigning, in partnership with Refuge, a leading UK domestic abuse charity launched the 'My money, my life' campaign to raise awareness and support of financial abuse.

Focus for 2017

- Successfully manage the potential sale process and Liability Management Exercise/capital raise, announced on 13 February 2017.
- Continue to focus on costs.
- Continue to ensure the Risk Management Framework is fully embedded across the Bank and progress IRB models remediation.
- Continue investment in the brand and development of products and services which reflect the Bank's customer-led Ethical Policy.
- Continue to focus on quality of service.

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CHAIRMAN'S STATEMENT

2016 was a year of both progress and challenge for The Co-operative Bank, culminating in the Board's decision announced on 13 February 2017 to commence a sale process and consider other options to build capital.

The Board has only been able to consider these options as a result of the considerable progress that has been made in delivering the Bank's turnaround plan over the last three years. The Bank is stronger in many areas than in 2013 and these options would simply not have been feasible before.

Since 2013, a viable Core Bank has been rebuilt, non-core assets have been reduced by more than half, legacy conduct issues have been substantially remediated, and risk management disciplines have been improved. We have resolved significant IT weaknesses with the successful migration of our key IT applications to an outsourced arrangement with IBM, resulting in the FCA confirming that we are no longer in breach of their Threshold Conditions for IT. Most importantly, we have a robust franchise anchored in our Values and Ethics which are clearly important to our customers and colleagues.

During 2016 we delivered further positive progress in rebuilding a customer-focused retail banking proposition with values and ethics at its heart; a proposition that we believe has the potential to grow further in the future. We also reached several key milestones in our turnaround plan, notably in separating our IT systems from The Co-operative Group, which will continue throughout 2017 and beyond, and in further embedding risk management, ensuring better customer outcomes.

At the same time, challenges emerged that impacted on our plan. A key factor has been the lower for longer interest rate environment which has affected the income and profitability profile of the Bank. In addition, the costs of transforming the Bank and fixing the legacy issues of the past, proved to be higher than we originally anticipated. These factors combined have constrained the Bank's ability to build capital in the medium term, and contributed to the Board decision and announcement of 13 February 2017. Further information is provided in the Outlook section of the Detailed Financial Review section of this report.

A key priority for the Board in 2016 was to achieve an orderly executive succession in the key roles of Chief Executive Officer (CEO) and Chief Financial Officer (CFO), and to ensure the smooth transition to the new Executive team to lead the Bank into the next phase of its turnaround. I was delighted to confirm the appointment of Liam Coleman as CEO of the Bank from 1 January 2017, succeeding Niall Booker, and to welcome John Worth to the Bank as CFO in October 2016, taking over from John Baines. I would like to express my thanks to Niall Booker and John Baines for their successful stabilisation of the Bank, which was achieved without cost to the British taxpayer. I look forward to working with Liam, John and the executive team as we take the Bank forward in 2017.

There was also change in our Non-Executive Directors with Graeme Hardie and Richard Coates stepping down from the Board during the year. In October 2016 we welcomed Glyn Smith onto the Board as an Independent Non-Executive Director along with Alistair Asher, who was nominated by The Co-operative Group as a Non Independent Non-Executive Director under the terms of the Relationship Agreement and joined the Board in September 2016. I would like to thank our Non-Executive Directors for their work and contribution during their respective terms.

On behalf of the Board, I would like to thank colleagues for their continuing commitment to our customers and our business, our customers for their continued loyalty and our investors for their continued support.

Dennis Holt
Chairman
08 March 2017

OUR BUSINESS AREAS

During 2016, the Core and Non-core business areas were managed as set out below to align with the Bank's plan to rebuild resilience, de-risk and reshape its balance sheet and to address the underlying issues it faces.

<table>
<tr><th></th><th>Core</th><th>Non-core</th></tr>
<tr><td>Definition</td><td>• 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) – focused on offering simple solutions to meet the needs of small business (SME) customers mainly focused around savings and current accounts. We continue to service our existing complex customers with a range of corporate banking facilities but it is small business where we are seeking to develop customers and deposits, in particular those in the Charity and Co-operative sectors

Treasury and Other</td><td>• Inconsistent with the Core business strategy and risk appetite
• Cannot be supported by Core business IT Retail platform
• Non-core assets are typically but not exclusively non-performing, defaulted, unprofitable and/or capital intensive products

Legacy Portfolio 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[2]
• 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)

Unity Trust Bank[1] (UTB) – Reduced shareholding</td></tr>
<tr><td>Focus</td><td>• 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
• Investment into digital channels
• Offering customers products that are easy to understand and use</td><td>• Managing these businesses to achieve deleverage that does not materially reduce the CET1 ratio of the Bank as a whole</td></tr>
</table>

1. UTB operates in the social economy and commercial banking sectors and was previously consolidated into the Bank's results on the basis of control. As of December 2015, the Bank's residual holding of Unity Trust Bank's shares reduced to 6.7%. This is treated as Non-core business.
2. Transferred to BaCB within Core in February 2016, transferred back to Non-Core in December 2016.

As of 1 January 2017, the Core and Non-core business split will no longer apply. This is in recognition of the need for the Bank to work as one business, with this one business structured into five Business Units. The construction of Business Units remains unchanged from the descriptions above and a summary of each as at 31 December 2016 is below.

Definition	Retail Banking	BaCB	Optimum	Legacy Portfolio	Treasury and Other
Managed Assets	£14.8bn	£0.4bn	£2.8bn	£1.5bn	£7.9bn
Managed Liabilities	£19.4bn	£2.7bn	-	£0.1bn	£4.0bn
Credit RWAs	£1.9bn	£0.5bn	£0.9bn	£1.1bn	£1.5bn
Operating Income	£372.8m	£63.3m	(£15.7m)	(£6.7m)	£34.3m

OUR STRATEGY AND BUSINESS MODEL

The Bank is focused on implementing its strategy of becoming a smaller, sustainable and efficient bank, distinguished by its values and ethics, that is focused on retail and SME customers.

Bank Vision

To become an efficient and financially sustainable UK Retail and SME Bank that is distinguished by its values and ethics

Overarching Strategy

Offer a differentiated proposition, serving a loyal customer base Serving Retail and SME customers with propositions differentiated through values & ethics, brand and customer service excellence	**Offer a choice of distribution channels** Offering distribution channels and services aligned to customer demand	**Offer a customer-centric product range** Offering simple, clear, fair and transparent products to meet customer needs	**Deliver a right sized operating cost base** Focus on reducing costs within a challenging macro environment

Underpinned by capital resilience and regulatory compliance

Key Activities and Actions

Retail and SME business strategy
Simplify and focus on Retail and SME customers
- Enhance returns
- Improve cost:income ratio
- Build on existing foundations and capabilities

Legacy Portfolio and Optimum business strategy
Actively manage to achieve the most appropriate value for each portfolio or target for run down to exit
- Taking into consideration liquidity and capital requirements

Key actions for the Retail and SME businesses:
- Streamline Retail and SME product offerings
- Focus on existing customer base and acquisition of 'prime' customers
- Communicate our 'difference' as experienced by customers, colleagues and communities
- Re-price to market/exit uneconomic products
- Consistently deliver first class customer service across every interaction

Key actions for the Legacy Portfolio and Optimum businesses:
- Active management of assets
- Single asset and portfolio sales
- Optimisation of borrowers' funding structures
- Re-banking of Non-core customers
- Run down or close business over the longer term

Key actions for the Bank as one business:

- Ensure our values and ethics are at the heart of everything we do and inform the decisions we make
- Reduce costs and simplify business processes
- Establish and embed an effective and efficient operational and governance structure
- Continue to embed the Risk Management Framework and strengthen our culture
- Manage reputational and conduct risk
- Energise and empower all colleagues to perform at their best

How we make money

The table below summarises the business activities performed by the Bank and the associated impact across the balance sheet, income statement and risk.

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, fees and may incur credit impairment charges	• Credit risk • Market risk • Operational risk • Liquidity and funding risk • Conduct risk
We collect 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	Minimal	We earn net fee and commission revenue	• Operational risk • Conduct risk
We invest in people in order to implement 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, Intangible assets	Other operating costs	• Operational risk • Strategic and business risk

CHIEF EXECUTIVE'S REVIEW 2016

Overview

In 2016, The Co-operative Bank continued to deliver progress against its turnaround plan, while at the same time facing a number of challenges. Building capital has always been part of our long term plans. However, our ability to do so organically has been constrained by a number of factors. As outlined by the Chairman, these factors together led to the Board's decision to commence a sale process and also consider other options to build capital, announced on 13 February 2017.

It is important to highlight that the Bank is stronger in many areas than in 2013. In 2016 our achievements reflected a number of significant steps forward as the Bank continued to address the legacy issues of the past, while building a renewed, digitally-enabled retail bank for the future, differentiated by its distinctive ethical brand and strong customer service.

The announcement of a sale and consideration of other options to build capital is therefore about how the Bank sees through the next stage of its turnaround plan, recognising there is considerable potential in the Bank given the strength of the brand, its reputation for strong customer service and distinctive position based on its Values and Ethics.

Progress since 2013

In 2013, our strategy was to stabilise the Bank and to reshape the business around our retail and SME customers and this is what we have done. A customer focused retail bank is emerging with an award-winning mortgage platform, a growing prime current account base and continued recognition for the service colleagues provide. We have continued to invest in our brand, maintained high customer satisfaction and invested in our digital services, whilst working to make the Bank fit for the future in terms of its cost base, infrastructure and risk management processes.

In terms of highlights, progress includes:

- High levels of customer satisfaction have been maintained, evidenced by Net Promoter Scores (NPS) that are consistently in the top four in the UK retail banking market;
- A new current account proposition, Everyday Rewards, was successfully launched in 2016, which contributed to a net increase in overall and prime current account customers;
- Continued investment in a differentiated brand through renewed TV advertising and campaigning and being recognised as the most improved brand by YouGov;
- Successfully built on the refreshed Ethical Policy relaunched in 2015 which sought greater involvement from customers as well as non-profit organisations. Customer research indicates the Bank is perceived as the UK's most ethical banking brand, and one of the most trusted;
- Significantly de-risked balance sheet with over half of the original Non-core portfolio sold in an orderly manner since 2013;
- The cost base has reduced by over 20% since 2014 and the ongoing cost reduction programme is intended to deliver further savings over the next 12 months;
- A comprehensive remediation programme has identified and substantially addressed a broad range of historic conduct issues;
- A successful digital transformation has been delivered and all current account customers who use online banking have been migrated to the new digital platform; and
- Overall IT resilience and stability has improved substantially since 2013, with stronger end-to-end disaster recovery capability. In a two year effort culminating over the weekend of 11 and 12 February 2017, the Bank migrated its core mainframe system and associated mid-range servers to IBM-managed data centres. The first half of 2017 will see us migrate a number of non-customer facing systems as the programme moves towards completion.

2016 progress rebuilding a viable Retail and SME bank

In 2016 we began to see the tangible results of our turnaround plan. New product development, digital transformation and brand marketing have all contributed to the re-establishment of an attractive proposition. Profitability was impacted in the second half of the year following the reduction in the base rate. However management action has focused on cost reduction and other measures designed to address this. Current account performance remained strong as prime current accounts increased by 8,303 and current account balances increased from £3,801.5m at the end of 2015 to £4,229.2m at the end of 2016. Our new current account proposition, Everyday Rewards, was launched in the first quarter of 2016. The product features the opportunity for customers to earn monthly cash rewards in return for responsible day to day usage of their account. Customers also have the option to donate their rewards to one of five charity partners. The launch was supported by a £150 switching incentive campaign which ran during times of the year where customers are most likely to switch, and was consistently one of the leading incentives on offer in the market. This new proposition has delivered a significant increase in customers joining the Bank and an eight-fold increase in customers using the Current Account Switch Service. This in turn has driven increasing numbers of customers opting into Everyday Rewards and growth in the volume of prime customers as a result.

At the same time, our digital programme continued to deliver planned improvements during 2016, and we are delighted that all current account customers now have the opportunity to benefit from our improved mobile banking app, and the availability of Apple Pay which we launched in October 2016.

Mortgage performance remained strong, driven primarily by our intermediary Platform operation, which was voted Intermediary Lender of the Year for the second year running at the Your Mortgage awards. Completions and redemptions for the year totalled £3.1bn and £1.7bn respectively compared to £2.8bn and £2.3bn in 2015.

During 2016 we focused on refreshing and rebuilding our ethical brand with renewed brand advertising, including a new TV advertising campaign and strapline 'It's good to be different' which highlights our ethical brand difference. Our research shows that we are consistently considered the most ethical banking brand by customers and non-customers, and with research highlighting that 37% of people would consider switching to an ethical bank, we plan to reinforce our ethical brand throughout 2017 to further distinguish our position in the market.

Our customer service credentials continue to set us apart from our competitors, with Net Promoter Scores (NPS) that are consistently in the top four of all UK banks. Our progress in this area is evidenced by the Institute of Customer Service recognising the Bank as the most improved banking brand and ranking us as a top 50 organisation for customer service. Our Financial Support Team also won Team of the Year at the CCA Excellence Awards, following the creation of a unique partnership with Citizens Advice Manchester to help customers in financial difficulty. It is heartening that others recognise our focus on excellent customer service and this is a key part of our customer proposition which we will seek to preserve.

During the course of 2016, we successfully integrated our Business and Commercial Banking operation into our retail business, reflecting our strategy to simplify our business and to streamline processes to better serve our SME customers. We also rationalised our SME product offering which made us easier to do business with and we have increased our focus on small enterprises. We have also recently enhanced the functionality of our online channel, which is indicative of our focus on improving the overall customer experience.

Overall Bank performance

Though legacy issues continued to impact on the overall financial performance of the business the statutory loss before taxation for 2016 narrowed to £477.1m compared to £610.6m in 2015. More information on the main drivers of the loss and the Bank's financial performance is included in the Detailed Financial Review, but in summary the results reflect the continued progress against the areas of focus outlined in the Bank's Strategic Plan, set against the 2016 interest rate cut, the ongoing low interest rate environment and the investment required to tackle the scale of the required transformation and legacy issues.

Remediation and strategic project costs remained high in 2016, reflecting investment in systems and processes. We do not anticipate similar levels of spend in 2017, as many of the transformation and remediation projects have now largely been completed. Additional one-off costs were also incurred as the Bank resolved all aspects of its existing contractual dispute and agreed revised terms relating to provision of mortgage administration services with Capita and the write off of associated transformation spend.

Capital

As previously stated, the lower for longer interest rate environment has impacted our plan and as a result our capital position. In January 2017 we provided an update to previous guidance that we now expect our CET1 ratio to fall and remain below 10% over the medium term, and that we will now no longer meet our ICG over the planning period to 2020. Further guidance is included in the Detailed Financial Review. The Bank continues to expect to meet its Pillar 1 regulatory capital requirements and to maintain sufficient liquidity to meet its obligations. The Board's decision to commence a sale process and consider additional options to build capital reflects the fact that due to the factors outlined earlier, the Bank is constrained in its ability to build its capital position organically.

Costs

We renewed our focus on our cost base in 2016, resulting in a reduction of £47.1m compared to 2015 with further management action planned for 2017. Operating costs fell 10% to £444.8m compared with £491.9m in 2015, driven by continued reduction of staffing levels, the impact of digital development and related branch rationalisation. Our branch network remains an important part of our multi-channel service and we continue to review customer behaviour as the declining trend in branch footfall continues. The 54 branch closures announced in January 2016 were completed by the end of June 2016, with a further 5 closed towards the end of the year. A programme of investment continues to improve our brand presence in core branches and we have recently moved to new premises in Manchester, Liverpool and in the near future, Sheffield. We are also planning to close an additional 10 branches by the end of 2017. This will result in a network of 95 branches, well placed across the UK. In addition, all Co-operative Bank customers can make everyday banking transactions via the Post Office's network of over 11,500 access points across the UK; around 6 million customer transactions were carried out via the Post Office network in 2016.

Values and Ethics

Our Values and Ethics, captured within our customer-led Ethical Policy are central to the way we operate as a Bank, and this sets us apart from our competitors. Our four million customers want an ethical approach to banking. 85% of our customers tell us our ethical credentials are one of the main reasons they choose to bank with us and our colleagues say this is a key reason why they want to work with us. 2017 will mark 25 years since our Ethical Policy was launched and over the past 25 years, over 320,000 customers have helped shape the policy.

We reached a milestone in 2016 where our customers have now donated over £5.0m to Oxfam over the course of a 20 year relationship between Oxfam and the Bank. In 2016 customer donations to our charity partners including the donations from our new Everyday Reward current account reached almost £880,000.

Our sponsorship for The Hive, which promotes the development of co-operative businesses, continued during 2016 with valuable support provided to new start up co-operative businesses. Our campaign in partnership with Refuge was successful in putting the issue of financial abuse in personal relationships firmly on the industry agenda, achieving a commitment to change industry practice, and this was recognised with a number of third sector awards. Our pioneering work on a pilot with Citizens Advice Manchester is making a tangible difference to vulnerable customers. We are extremely proud of our achievements in this area.

People and Culture

As the Chairman has said, Executive succession was a key priority during 2016. In addition to my appointment as CEO, John Worth joined the Bank as Chief Financial Officer in October 2016 replacing John Baines and Steven Pickering was appointed Chief Risk Officer effective from 8 August 2016. Tracey Kneller was appointed to the role of Human Resources Director at the end of 2016, and Heather Lauder, Matthew Carter and Ashley Lillie joined the Executive Committee as Director of Retail and Business Banking, Director of Products and Communications and Treasurer respectively. I am looking forward to working with them and with the wider Executive team as we continue to deliver our plan in 2017.

A number of colleagues left the Bank in 2016 as part of cost reduction initiatives. As a necessary step to support the Bank in achieving its cost cutting and rationalisation targets, it is nonetheless regrettable. I would like to thank colleagues for their continued professionalism and customer focus during the year.

We have also seen good progress in improving the culture of the Bank. Our focus on culture in 2016 saw colleagues attending 'Making the Difference' workshops where we looked at the desired and emerging culture of the Bank, focused on risk management, our customers, cost effectiveness and efficiency and our Values and Ethics. Our focus on the cost effectiveness of the Bank includes continuing to improve the working environment for our colleagues. We have modernised and refreshed our Skelmersdale site and similar initiatives are underway across our major occupancies.

We were proud to be among the first banks to sign up to the Government's Women in Finance initiative in September 2016, setting a target of 40% of women in senior management roles by 2020.

Resilience and risk management

Ensuring a more resilient Bank is a key objective and our renewal and outsourcing of the Bank's IT infrastructure management is central to this objective. Within our Enterprise Services outsourcing programme we completed the successful move of the first set of systems to the new IBM data centres in April 2016. This allowed us to bed down the new data centres and the new IBM managed service ahead of the major migration of the Bank's core systems, including the mainframe. During a weekend in February 2017 the Bank migrated its core banking operations into the new IBM-managed data centres. This marks a major milestone in the orderly separation and migration of core IT systems from The Co-operative Group to the outsourced managed service with IBM. The Bank has received confirmation from the FCA that they consider the breach of Threshold Conditions has been successfully remediated and the Bank to now be compliant with Threshold Conditions. This puts us in a great position to complete the Enterprise Services project in the first half of 2017, although ongoing separation of activity of residual IT service shared with The Co-operative Group will continue beyond 2017.

During 2016 we continued the embedding of our Risk Management Framework in the Bank, which reinforced knowledge and understanding, risk leadership and improved risk reporting and governance. This included a comprehensive programme of risk training and awareness delivered to all colleagues which re-emphasised the key message that managing risk is something that all colleagues need to do as part of their everyday activity. This is a critical part of our ongoing work to further improve the culture of the Bank, and is an area where we have made good progress.

Summary

While we continued to deliver in key areas of the plan in 2016, the combined impact of lower for longer interest rates and the higher than anticipated cost of transforming the Bank and addressing legacy issues mean that we are now more limited in our ability to build capital organically. This is reflected in the Board's decision to commence a formal sale process and consider other options to build capital for the future; this decision is in the best interests of all our stakeholders and the right route forward at this stage in the turnaround. This process is currently underway and, in the meantime, we continue to focus on what we do best - delivering an ethical banking proposition for our customers.

We believe there is value in our distinct position in the market and that the relationship we have with customers, centred on our values and ethics, distinguishes us and remains a key reason why four million customers choose to bank with The Co-operative Bank. The Board and the management team believe there is strong potential to build the franchise, using the strength of our brand, our reputation for strong customer service and our distinct values and ethics. In a market where there is little to distinguish many banking brands, we believe this continues to set us apart.

Liam Coleman
Chief Executive Officer

DETAILED FINANCIAL REVIEW

Capital

In 2016 the Bank's capital ratios have deteriorated owing to the continued losses which have eroded capital resources. These have not been offset by similar levels of RWAs reduction seen in prior periods primarily as a result of a lower rate of deleverage of Non-core assets.

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

The Bank's Common Equity Tier 1 (CET1) capital resources have decreased by £0.4bn in the period to £0.7bn, primarily as a result of the £418.7m statutory loss after tax for the year.

Core Credit Risk RWAs have increased to £3.9bn (2015: £3.7bn), driven by increased lending within the Retail secured portfolio. Operational Risk RWAs have decreased by £0.2bn following the annual recalculation of the Pillar 1 Operational Risk requirement subsequent to the 2015 year end results.

Non-core RWAs have reduced from £2.8bn to £2.0bn, driven by the continued deleverage of the Legacy Portfolio and natural run off within Optimum.

The movements outlined above are the primary factors resulting in the Bank's CRD IV CET1 ratio decreasing by 4.5% from 15.5% to 11.0%.

The Bank continues to hold a £0.3bn temporary RWA adjustment within the Optimum RWAs (2015: £0.3bn) due to historic deficiencies relating to the Bank's secured Loss Given Default (LGD) and Probability of Default (PD) models. Having conducted further analysis, the Bank now intends to remove the remaining £0.3bn temporary adjustments in March 2017.

The Bank's total capital ratio stands at 17.7% as at 31 December 2016 (2015: 21.6%) relative to the Pillar 1 regulatory minimum of 8%.

The Bank's leverage ratio is 2.6%, down 1.2% from 2015, reflecting the reduction in CET1 capital driven by the statutory loss in the year. The Bank is not currently subject to the 3% minimum requirement as it has retail deposit levels below £50bn, the threshold at which it becomes a binding requirement.

CRD IV capital position

	2016	2015	Change
CET1 Resources post Regulatory adjustments (£m)	**736.9**	1,151.1	(414.2)
RWAs (£m)	**6,676.1**	7,422.9	(746.8)
CET1 ratio	**11.0%**	15.5%	(4.5%)
Total capital	**17.7%**	21.6%	(3.9%)
Leverage ratio	**2.6%**	3.8%	(1.2%)

Regulatory requirements

As at 31 December 2016, the Bank did not meet its Individual Capital Guidance (ICG), the PRA's statement as to the regulatory capital (Pillar 1 and Pillar 2a) it expects the Bank to hold. The Bank has received an updated ICG from the PRA which came into force from 1 November 2016. As at 31 December 2016, the Bank's Pillar 2a requirement was set at 14.49% of RWAs or £967.4m.

Maximum Distributable Amount

The Bank does not currently meet its ICG and Combined Buffer. Under the PRA rulebook, not meeting the Combined Buffer prevents the Bank from paying dividends, making distributions and creating an obligation to pay variable remuneration during the period of non-compliance. To remain competitive and to enable the attraction and retention of employees, the Bank agreed a fixed pay award for the bulk of employees amounting to £3.6m which has been paid in 2016. For more information refer to the Directors' Remuneration Report.

Liquidity

Overview

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

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

- manage retail deposits to match balance sheet assets and reduce the cost of the liability base;
- ensure the liquid asset buffer predominantly comprises of highly liquid securities, allowing for limited reliance on short dated secured funding sources;
- maintain the availability of mortgage collateral to support the secondary liquidity position; and
- repay wholesale funding to manage the balance sheet and the Bank's liquidity position.

Credit rating

On 15 February 2017, Moody's announced that it had downgraded the Bank's long term senior unsecured rating to Ca from Caa2 with a developing outlook. On 21 February 2017 Fitch downgraded the Bank's long term Issuer Default Rating (IDR) to B- from B with an evolving outlook. The Bank's current ratings are:

	Long term	Short term
Moody's	Ca	Not prime
Fitch	B-	B

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

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

Liquidity portfolio

The Bank's liquidity resources, as at 31 December 2016, were £8.2bn compared to £10.2bn as at 31 December 2015. As at 31 December 2016 the liquid asset ratio was 13.8% (31 December 2015: 15.6%). The Bank continues to hold liquidity in excess of minimum expectations which is in line with the rest of the industry.

Primary liquidity has decreased over the period by £0.7bn and secondary liquidity has decreased by £1.3bn. Primary liquidity consists of liquid assets that are eligible under European Banking Authority (EBA) regulations (high quality liquid assets). Secondary liquidity comprises of liquid unencumbered investment securities not included as part of primary liquidity as well as other forms of contingent liquidity sources. In the 2015 Annual Report and Accounts contingent liquidity included all other non-primary liquid assets. The Bank has now narrowed the contingent liquidity definition in the statutory accounts to only include unencumbered assets (excluding liquid investment securities) eligible for central bank facilities and therefore the 2015 comparatives have been restated to align with this change. The reduction in secondary liquidity in 2016 reflects a combination of amortisation of assets, sales and management of secured funding collateral requirements to support the Bank's funding profile, and collateralisation of the Britannia pension scheme.

	2016 £m	2015 £m	Change £m
Operational balances with central banks	**2,571.4**	2,329.3	242.1
Gilts	**676.2**	1,450.2	(774.0)
Central government and multilateral development bank bonds	**568.5**	760.2	(191.7)
Total primary liquidity	**3,816.1**	4,539.7	(723.6)
Total secondary liquidity	**4,424.2**	5,707.4	(1,283.2)
Total liquidity	**8,240.3**	10,247.1	(2,006.8)

Retail and commercial funding

The majority of the Bank's funding comes from Retail and Commercial accounts. As at 31 December 2016, customer deposits were £22.4bn compared to £22.8bn as at 31 December 2015.

Customer deposits reduced over the period by £0.4bn, driven mainly by Retail savings segments. The reduction in Retail savings balances reflects the Bank's strategy to manage its deposit base to match asset funding requirements and manage the cost of liabilities. These activities are partly offset by an increase in Retail current accounts. Corporate deposits remained stable in the year.

	2016 £m	2015 £m	Change £m
Current accounts			
Retail	**4,229.2**	3,808.3	420.9
Corporate	**2,105.1**	2,106.6	(1.5)
Total current accounts	**6,334.3**	5,914.9	419.4
Instant access savings accounts			
Retail	**6,384.0**	6,580.6	(196.6)
Corporate	**482.4**	486.1	(3.7)
Total instant access saving accounts	**6,866.4**	7,066.7	(200.3)
Term deposits and bonds			
Retail	**3,947.7**	4,277.3	(329.6)
Corporate	**249.2**	281.4	(32.2)
Total term deposits and bonds	**4,196.9**	4,558.7	(361.8)
Individual savings accounts (ISA)			
Retail – ISA Fixed	**2,491.7**	2,355.9	135.8
Retail – ISA Demand	**2,351.5**	2,622.6	(271.1)
Total ISA accounts	**4,843.2**	4,978.5	(135.3)
Other deposits	**196.1**	290.6	(94.5)
Total customer deposits	**22,436.9**	22,809.4	(372.5)

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, and repurchase agreements.

The repayment of the final £150.0m FLS drawing was made in January 2016. Leek 17 and 18, and Silk Road 3 securitisations matured over the course of 2016.

	2016	2015	Change
	£m	£m	£m
Preference shares, PSBs and subordinated debt	**456.0**	457.0	(1.0)
Secured funding	**1,197.6**	2,091.0	(893.4)
Repos	**990.6**	671.3	319.3
Market borrowing	**4.1**	10.9	(6.8)
MTNs	**405.4**	404.9	0.5
Total wholesale funding	**3,053.7**	3,635.1	(581.4)

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

The table below analyses contractual maturities (as opposed to internally expected repayment dates), with the exception of Leek 19 notes being disclosed based on its call date:

	2016	2015	Change
	£m	£m	£m
Repayable in less than 1 month	**837.4**	522.5	314.9
Repayable between 1 and 3 months	**-**	159.7	(159.7)
Repayable between 3 and 6 months	**528.9**	352.4	176.5
Repayable between 6 and 9 months	**405.4**	243.3	162.1
Repayable between 9 and 12 months	**67.9**	433.0	(365.1)
Repayable between 1 and 2 years	**-**	746.9	(746.9)
Repayable between 2 and 5 years	**1,008.1**	259.0	749.1
Repayable in more than 5 years	**206.0**	918.3	(712.3)
Total external funding	**3,053.7**	3,635.1	(581.4)

Basis of preparation

The figures referenced and presented within the Detailed Financial Review are on a management accounts basis. A reconciliation of these numbers to the statutory accounts is provided in the segmental information in note 3.

Prior period re-presentations

	2015	Re-presentations	Re-presented 2015
	£m	£m	£m
Retail net interest income	421.7	(20.0)	401.7
Treasury and Other net interest income	(3.0)	20.0	17.0
Direct costs	(180.0)	22.1	(157.9)
Operations and Head office overheads	(311.9)	(22.1)	(334.0)
Strategic project expenditure	(99.7)	8.0	(91.7)
Severance	-	(8.0)	(8.0)

There are three re-presentations to certain segmented allocations included within the 2015 Annual Report and Accounts.

1. £20.0m net interest income from Retail to Treasury relating to the liquidity transfer pricing generated from the Bank's free reserves (equity).
2. £22.1m of costs associated with the property and estates functions has been re-presented in Operations and Head Office overheads from Retail direct costs.
3. £8m of costs associated with the costs of implementing the Bank's revised target operating model, reported separately from strategic project expenditure.

Core Balance Sheet re-presentations and impact on prior year net interest margin (NIM)

The Bank has re-presented £0.5bn of assets from unallocated to Core Bank at 31 December 2015 which has reduced the 2015 Core Bank NIM to 1.89%.

	2015	Re-presentations	Re-presented 2015
	£m	£m	£m
Core Bank interest income	460.6	-	460.6
Closing 2014 Core Assets	25,476.2	-	25,476.2
Closing 2015 Core Assets	22,819.0	497.2	23,316.2
Core Bank NIM	1.91%	(0.02%)	1.89%

2015 Balance Sheet representations

The Bank has re-presented the 2015 balance sheet. This is driven by a reallocation of £0.5bn of previously unallocated assets and £1.0bn of previously unallocated liabilities across the Core and Non-core Business segments.

Total Bank financial performance

Bank performance

	2016	2015	Change
	£m	£m	£m
Net interest income	**394.8**	471.5	(76.7)
Losses on asset sales	**(13.5)**	(121.4)	107.9
Non-interest income	**66.7**	69.9	(3.2)
Operating income	**448.0**	420.0	28.0
Operating expenditure	**(444.8)**	(491.9)	47.1
Operational projects	**(33.9)**	(49.7)	15.8
Impairment (losses)/gains on loans and advances	**(2.3)**	48.6	(50.9)
Operating result	**(33.0)**	(73.0)	40.0
Remediation projects	**(141.3)**	(124.5)	(16.8)
Strategic projects	**(134.3)**	(91.7)	(42.6)
Severance	**(21.5)**	(8.0)	(13.5)
Sale of Visa Europe share	**58.1**	-	58.1
Share of post-tax profits from joint ventures	**0.3**	0.7	(0.4)
Conduct and legal risk	**(24.9)**	(193.7)	168.8
Fair value amortisation	**(180.5)**	(120.4)	(60.1)
Loss before taxation	**(477.1)**	(610.6)	133.5
Net interest margin	**1.39%**	1.42%	(0.03%)
Cost:income ratio	**103.7%**	100.0%	3.7%

The Bank's statutory loss before taxation for 2016 is £477.1m. The figures referenced and presented on these pages are on a management accounts basis. A reconciliation of these numbers to the statutory accounts is provided in the segmental information in note 3.

The 2016 financial results reflect the continued progress against the areas of strategic focus for the Bank, the cost of ongoing legacy issues with regards to fair value unwinds, the impact of a smaller asset base and continued competitive pricing on assets.

The cost:income ratio has increased in the year by 3.7% from 100.0% to 103.7%. The reductions in operating expenditure and operational project expenditure has been more than offset by the reduction in interest income and net interest margin.

Despite a year on year reduction in the Bank's average cost of funding, total net interest income has fallen as a result of a lower asset base following continued Non-core deleverage, increased competition on new business mortgage pricing and the reduction in the Bank of England base rate. Unity Trust Bank is now regarded as an investment rather than fully consolidated, following a 20.0% reduction of the Bank's shareholding in 2015. The result of this has accounted for £8.3m of the reduction in net interest income.

Non-interest income has reduced relative to the prior year. Underlying non-interest income has fallen predominantly within the Retail business, driven by a reduction in Link commission fees following the disposal of the majority of the ATM estate which was completed in Q1 2015 and lower overdraft fees following the launch of the new overdraft proposition in April 2015. The full year impact of reductions in merchant interchange fees on credit cards has further reduced non-interest income. These reductions are partially offset by a one-off gain in February 2016 following the sale of part of the Bank's gilt portfolio.

Losses on asset sales have reduced to £13.5m, following a year on year reduction in the rate of Non-core deleverage.

The Bank has continued to deliver a significant reduction in operating expenditure, down £47.1m on the previous year, reflecting the progress of cost reduction initiatives. Cost reductions are mainly as a result of the continued focus on improving efficiency and simplification of Bank processes and resulting in the reduction in operating staff costs of £30.3m and the full year recurring benefit from initiatives undertaken in 2015 such as the Branch network rationalisation, FTE (full time equivalents) reductions and the cessation of costs associated with Unity Trust Bank, which are no longer consolidated into the Bank's results.

The FSCS levy was £15.1m lower year on year as the Bank was not subject to the payment of the capital levy element in 2016 and overall levy interest payment outlook being lower than the previous year. This also includes a £1.0m refund due to over payment in the prior year.

Total project expenditure across operational, remediation and strategic projects was £309.5m. Investment activities continue to progress; these include: the transformation of IT resilience, remediation of systems and processes, transforming the Core Bank's operations and strengthening the Core Bank. Furthermore, the Bank has continued to commit investment into digital channels resulting in upgrades to the internet and mobile banking platforms and improved digital product offerings. Total project expenditure includes costs associated with the programme of work to transform the Bank and also a write-off of assets relating to the transformation element of mortgage outsource servicing, which is no longer being progressed.

The Bank's financial performance continued to be impacted by legacy items, particularly the fair value unwind related to the merger with Britannia Building Society of £180.5m. Conduct and legal risk charges totalled £24.9m in the year, a decrease of £168.8m compared to 2015, representing the maturity of the redress and remediation programme and further certainty around the redress requirements of a number of open conduct risks.

Operating expenditure

	2016	2015	Change
	£m	£m	£m
Core direct costs	**(126.4)**	(143.1)	16.7
Non-core direct costs	**(9.4)**	(14.8)	5.4
Total direct costs	**(135.8)**	(157.9)	22.1
Operations and Head Office overheads	**(309.0)**	(334.0)	25.0
Total operating costs	**(444.8)**	(491.9)	47.1
Of which: staff costs	**(187.7)**	(218.0)	30.3

Total operating expenditure reduced by £47.1m from £491.9m to £444.8m.

Direct costs include those relating to the staff and operations of the specific business units, for example the product and marketing teams, and branch staff within the Retail and SME portfolio.

Operations and Head Office costs cover those functions that support Bank-wide operations, including HR, Finance, IT and Risk.

Core direct costs

The key drivers of the £16.7m reduction are the savings from the 2015 and 2016 branch rationalisation activity and other cost saving initiatives, including a reduction in discretionary marketing spend. This is in line with the Core Bank strategy of a shift to digital for new and existing customers.

Unity Trust Bank is now regarded as an investment rather than fully consolidated, following a 20.0% reduction of the Bank's shareholding in 2015, which has contributed a £10.3m of reduction in Core direct costs year on year. The Bank's shareholding is 5.97% as at 31 December 2016.

Non-core direct costs

Continued focus on deleveraging of the Non-core portfolio has driven savings of £5.4m with a significant element of this reduction due to lower staff costs.

Operations and Head Office overheads

Operational cost savings have been primarily driven by the 2015 initiatives including ATM rationalisation, process improvement and paper correspondence reduction. These activities combined with further efficiency savings and lower processing costs (due to a reduction of 59 in the branch network).

The FSCS levy was £15.1m lower year on year as the Bank was not subject to the payment of the capital levy element in 2016 and overall levy interest payment outlook being lower than the previous year. This also includes a £1.0m refund due to over payment in the prior year.

Full time equivalent (FTE) headcount

At a total Bank level, operating staff costs have reduced by £30.3m to £187.7m. Year-end permanent staff numbers (full time equivalents) have fallen by 865 to 3,605 with direct pay falling by £18.3m. The number of short to medium term specialist contractors and temporary resource at year end has increased from 234 to 290 to support a temporary increase of activity in contact centres following Digital migration. Contractor costs have fallen by £5.5m to £17.5m.

Please note that these exclude any FTE and associated expenses relating to the Bank's project expenditure.

Project expenditure

	2016	2015	Change
	£m	£m	£m
Operational projects expenditure	**(19.5)**	(27.0)	7.5
Operational projects depreciation	**(14.4)**	(22.7)	8.3
Operational projects	**(33.9)**	(49.7)	15.8
Remediation projects expenditure	**(131.4)**	(121.0)	(10.4)
Remediation projects depreciation	**(9.9)**	(3.5)	(6.4)
Remediation projects	**(141.3)**	(124.5)	(16.8)
Strategic projects expenditure	**(127.3)**	(84.2)	(43.1)
Strategic projects depreciation	**(7.0)**	(7.5)	0.5
Strategic projects	**(134.3)**	(91.7)	(42.6)
Total project expenditure	**(309.5)**	(265.9)	(43.6)
Severance	**(21.5)**	(8.0)	(13.5)

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

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

The charge for 2016 was £33.9m (2015: £49.7m) of which £14.4m (2015: £22.7m) relates to depreciation of previous investments. Key current projects include: Cheque Imaging; Customer Complaints Handling & Reporting; EU Payment Account Directive; and other smaller projects, ensuring regulatory and mandatory requirements of the Bank are met. In addition, there has been £3.0m impairment of smaller assets.

2016 spend reduced by £7.5m (excluding depreciation) largely due to the Regulatory Reporting Programme having completed in 2015, with the depreciation reduction (£8.3m) being driven by the transfer of shared assets to The Co-operative Group as part of separation.

Remediation projects
Remediation projects relate to IT remediation and resiliency as well as activity associated with Bank separation from The Co-operative Group.

The 2016 cost of £141.3m (2015: £124.5m) includes depreciation of £9.9m (2015: £3.5m). Key projects include: Enterprise Services (ES) outsourcing and separation from The Co-operative Group (£89.1m including £41.6m net reduction of provision); Core IT £14.7m and Data and Reporting £10.6m. Other smaller projects total £17.0m for ongoing remediation issues identified.

The key driver for the increased costs against 2015 is additional spend on ES driven by provision raised in 2016 for further cost required to achieve separation £18.9m, and impact of delays with the go live of certain remaining elements now being achieved in February 2017.

Strategic projects
Strategic projects relate to those projects that are transformational in nature and deliver cost or income benefits to the business. Project costs of £134.3m (2015: £91.7m), including depreciation of £7.0m (2015: £7.5m), reflect continued investment to enhance capability across the organisation. This includes £81.9m associated with the programme of work to transform the mortgage outsource service, which is no longer being progressed. This amount includes: expenses and fee payments associated with cessation of the transformation contract with the outsourced mortgage provider (£11.0m), a write-off of assets no longer expected to be in use (£48.5m), and other programme costs (£22.4m). The asset write-off of £48.5m includes impairment of intangible assets (£32.5m) and prepayments (£16.0m). Other projects included: digital (£19.0m), further branch transformation with closure of an additional 59 branches in 2016 (£10.9m), and the completion of other smaller projects (£15.5m).

Severance
The 2016 costs of organisational design changes are £21.5m (2015: £8.0m), reflecting accelerated implementation of the Bank's target operating model.

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

Capital expenditure

	2016	2015	Change
	£m	£m	£m
Operational projects	**(2.2)**	6.5	(8.7)
Remediation projects	**2.8**	9.1	(6.3)
Strategic projects	**(21.2)**	45.5	(66.7)
Total project capital expenditure	**(20.6)**	61.1	(81.7)

The Bank capitalises some of its expenditure on projects. Impairment of capitalised assets is offset against any capitalised expenditure, and is included within project expenditure.

Operational projects' negative capital expenditure relates to intangible asset impairment resulting from a change in the Bank's strategic cheque imaging solution.

Remediation capital expenditure in 2016 related to the models programme; 2015 was driven by Enterprise License Agreement (ELA) (£7.8m) as part of Enterprise Service Outsourcing.

Strategic capital expenditure in 2016 includes capitalisation of digital programme costs of £11.3m (2015: £20.2m), offset by impairment of mortgage outsourcing assets from prior years which are no longer expected to be brought into use of £33.6m.

Impairment (losses)/gains on loans and advances

	2016	2015	Change
	£m	£m	£m
Core impairment	**(0.1)**	(0.3)	0.2
Non-core impairment	**(2.2)**	48.9	(51.1)
Total impairment (losses)/gains on loans and advances	**(2.3)**	48.6	(50.9)

Total impairment of £2.3m in 2016 compares with gains of £48.6m of total impairment in 2015.

Non-core net impairment charge in 2016 of £2.2m is £51.1m higher than last year. 2015 saw significant impairment write backs driven by assets being disposed or revalued above previous book value. Lower levels of deleverage in the period coupled with cases moving into default have significantly reduced these benefits in 2016. Non-core (losses)/gains on asset sales includes a £9.6m impairment release in connection with the restructure of a Legacy Portfolio syndicated loan during the year. This impairment release is included in 'Impairment gains/(losses) on loans and advances' within the Bank's Income Statement as per note 3 of the financial statements.

Core net impairment charge of £0.1m is driven mainly by the Retail business segment.

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

Conduct and legal risk charges

	2016	2015	Change
	£m	£m	£m
CCA	**10.0**	(98.7)	108.7
PPI	**(36.0)**	(71.8)	35.8
Packaged Accounts	**-**	(16.8)	16.8
Mortgages	**(10.4)**	(0.6)	(9.8)
Other	**11.5**	(5.8)	17.3
Total	**(24.9)**	(193.7)	168.8

The 2016 charges relating to conduct and legal risk were £24.9m (2015: £193.7m). The reduction year on year was driven by the significant progress made across the redress and remediation programme.

Overall complaint redress performance in the year to 31 December 2016 has been slightly better than expected. The £36.0m charge in 2016 has been recognised to reflect the Bank's year end estimates of the impact of both the FCA Consultation Paper CP16/20 and the FCA announcement on 2 March 2017 that the time bar will end on 29 August 2019.

As at the reporting date the Bank had predominantly completed and closed its Consumer Credit Act (CCA) proactive redress programme. The 31 December 2016 CCA provisions includes a £10.0m net release following near-completion of the programme with the remainder of the provision required to continue work to develop a solution to address accounts becoming non-compliant again. This work is expected to be completed in H1 2017.

Overall conduct charges relating to Mortgages were £10.4m. A conduct issue relating to legacy system issues was identified in 2016 resulting in the creation of the Mortgage Rectification programme. This predominantly relates to the incorrect customer monthly mortgage payment calculation resulting in the under or overpayment of interest or capital. The scope and initial view of redress requirements were defined and calculated at YE 2016 resulting in an additional £20.1m provision. Across 2016 pre-existing mortgage remediation activities were substantially progressed and resulted in an offsetting £9.7m release.

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

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

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

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

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

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

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

The Bank's cost of funding is updated annually and results in changes to the rates which Core assets are charged and the rates which Core liabilities are compensated between periods. For Non-core assets and liabilities the rates have remained unchanged period on period.

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

Core

Core contribution

	2016	Re-presented 2015	Change
	£m	£m	£m
Net interest income	**412.7**	460.6	(47.9)
Gains/(losses) on asset sales	**0.5**	(0.8)	1.3
Non-interest income	**57.2**	52.4	4.8
Operating income	**470.4**	512.2	(41.8)
Direct costs	**(126.4)**	(143.1)	16.7
Impairment gains/(losses) on loans and advances	**(0.1)**	(0.3)	0.2
Contribution result	**343.9**	368.8	(24.9)
Operations and Head Office overheads	**(309.0)**	(334.0)	25.0
Operational projects	**(33.9)**	(49.7)	15.8
Operating result	**1.0**	(14.9)	15.9
Net interest margin[1]	**1.78%**	1.89%	(0.11%)

	2016	Re-presented 2015	Change
	£m	£m	£m
Assets	**23,171.4**	23,316.2	(144.8)
Liabilities	**26,116.7**	26,581.9	(465.2)

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

Core Bank operating profit, comprising Retail, BaCB and Treasury and Other, of £1.0m in 2016 include a number of significant one-off items, including a £15.9m gain on sale achieved on AFS gilts held as a hedge for the LME subordinated debt issuance, a one-off £7.3m interest income credit relating to prior year subsidiary accounting adjustments, and £4.6m of interest income of assets transferred to BaCB from Legacy Portfolio for the majority of 2016, which were transferred back to Legacy portfolio in the during Q4.

Core Bank contribution, reduced by £24.9m to £343.9m.

Retail contribution reduced by £67.1m, due to a reduction in non-interest and interest income. This reduction is partially offset by direct cost savings.

BaCB contribution increased by £12.0m, as a result of lower interest expense on deposits following customer repricing in the prior period and an increase of £4.6m relating to the interest income of assets transferred to BaCB from Legacy Portfolio for the majority of 2016, reflecting a strategic decision to manage these assets within the Core Bank. These assets have subsequently been transferred back to Legacy Portfolio, prior to the reporting date, following a further review.

Treasury and Other contribution increased by £30.2m partly as a result of a one-off £15.9m gain on sale achieved on AFS gilts held as a hedge for the LME subordinated debt issuance, and a one-off £7.3m interest income credit relating to prior year subsidiary accounting adjustments. This is partially offset by the fall in net transfer pricing revenue generated within Treasury, following changes in the Bank's balance sheet.

These are discussed in more detail in the following sections.

Core net interest margin (NIM) has reduced relative to the prior period with a NIM of 1.78% (2015: 1.89%). The Core Bank has delivered significantly higher volumes of mortgages in 2016 when compared to 2015, as a result of more competitive pricing. This results in an overall reduction in the Bank's asset margin which has been partially offset by improvements in underlying liability margins.

Core assets have reduced marginally to £23.2bn, down £0.1bn. There have been movements in the year relating to a fall in Treasury and Other assets of £0.7bn and £0.1bn in BaCB which have offset by a £0.7bn increase seen in the Retail asset book.

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

Retail contribution

	2016 £m	Re-presented 2015 £m	Change £m
Net interest income	**344.8**	401.7	(56.9)
Non-interest income	**28.0**	43.2	(15.2)
Operating income	**372.8**	444.9	(72.1)
Direct costs	**(114.1)**	(116.0)	1.9
Impairment gains/(losses) on loans and advances	**(0.6)**	(3.7)	3.1
Contribution result	**258.1**	325.2	(67.1)

	2016 £m	Re-presented 2015 £m	Change £m
Customer assets	**14,844.6**	14,123.2	721.4
Customer liabilities	**19,405.1**	19,754.8	(349.7)

Retail customer assets have seen a positive year in mortgage originations and overall mortgage balance growth of £0.7bn (2015 was a net reduction of £0.2bn). This was driven by originations of £3.1bn (up from £2.8bn in 2015), which continues to be mainly through the Platform Broker channel for which the Bank has won the 'Intermediary Lender of the Year' award. Buy-to-let (BTL) originations have fallen slightly year on year driven by the changes announced in the 2016 Budget and regulatory changes in the BTL affordability calculations required to be implemented by the end of 2016. Redemptions have also been lower this year at £1.7bn (2015: £2.3bn) which is partially due to a slower reduction in mortgage market rates across 2016, making it less attractive for customers to break their present deals than in 2015.

Retail customer liabilities have seen a slight, managed decline in the year. Current account balances have seen a continued increase during 2016 of £0.4bn (2015: £0.3bn). This is driven by stock increase after the launch of the Everyday Rewards current account in January and successful incentive led switching campaigns at key points during 2016. Retail savings has seen a managed reduction in balances of £0.8bn, down significantly from the £6.0bn reduction in 2015. This year's reduction sees greater stabilisation in the portfolio after maturity of a large volume of legacy high rate term deposits in line with the Bank's liquidity risk appetite.

Retail contribution has reduced by £67.1m to £258.1m (2015: £325.2m). Direct costs have improved marginally by £1.9m which is offset by £56.9m and £15.2m reductions in net interest income and non-interest income respectively.

The overall Retail asset margin has narrowed, driven by the competition and the downward trend on mortgage rates seen in the UK mortgage market over the last two years; this is having a more profound effect now that the portfolio is growing.

Interest expense on Retail savings has fallen substantially year on year as a result of pricing changes made across 2015 and 2016, this has however been partially offset by significant reduction in the year on year average liability balance along with lower rates received on liabilities, as a result of the Bank's internal transfer pricing policy. The 2016 result has also to a lesser extent been impacted by The Bank of England base rate reduction which has narrowed the margins on variable savings.

Lower interest rate expectations versus those anticipated in 2015 have resulted in a lower effective interest rate credit in 2016 of £5.0m (2015: £8.8m).

Retail non-interest income reduced to £28.0m (2015: £43.2m), primarily due to a full year's impact of the reduction in size of the Bank's ATM estate which took place across the first quarter of 2015. Additionally the implementation of the revised policy on overdraft fees, which is aligned to the Bank's ethical stance, lower credit card Merchant Interchange Fees and the launch of the Everyday Rewards current account with the associated reward payment costs has accounted for the further reduction.

The overall impairment charge for Retail was £0.6m, representing a £3.1m benefit on 2015 primarily within the unsecured loan portfolio driven by the ramp up of collections activity as loans were released from the Consumer Credit Act (CCA) remediation project.

Business and Commercial Banking contribution (BaCB)

	2016	Re-presented 2015	Change
	£m	£m	£m
Net interest income	**50.6**	41.9	8.7
Non-interest income	**12.7**	11.6	1.1
Operating income	**63.3**	53.5	9.8
Direct costs	**(6.1)**	(9.3)	3.2
Impairment gains/(losses) on loans and advances	**0.3**	1.3	(1.0)
Contribution result	**57.5**	45.5	12.0

	2016	Re-presented 2015	Change
	£m	£m	£m
Customer assets	**434.9**	564.2	(129.3)
Customer liabilities	**2,719.3**	2,689.2	30.1

The BaCB portfolio contributed £57.5m in 2016, a £12.0m increase on prior year.

Customer liabilities have remained constant at £2.7bn, with low levels of current account organic growth offsetting outflows of fixed rate deposits.

Customer assets have decreased from £0.6bn to £0.4bn as customer repayments have been greater than new business inflows. Net interest income increased to £50.6m in 2016 from £41.9m. The increase is primarily driven by revised hedging policies for non-interest bearing current accounts and a full year's benefit of liability pricing changes implemented in late 2015. This has been slightly offset due to margin compression on liabilities following the Bank of England base rate reduction to 0.25%.

As disclosed in the 2016 Interim Financial Report, £0.4bn of Private Finance Initiative (PFI) and Renewable Energy and Asset Finance (REAF) assets were transferred from Legacy Portfolio into BaCB as a result of a re-assessment of the credit quality of the loans, the blended return on capital of the portfolios and the alignment to the Bank's Ethical Policy.

Following further management review of the go forward SME Banking strategy in H2 2016, BaCB will focus on developing a business banking proposition for small businesses, delivering simple solutions for the needs of small business customers mainly focused around savings and current accounts. As a result of this review the PFI and REAF assets transferred back to the Legacy portfolio in H2 2016 and are included within the Legacy Portfolio at the reporting date.

These assets contributed £4.6m of BaCB net interest income in 2016.

Treasury and Other business contribution

	2016 £m	Re-presented 2015 £m	Change £m
Net interest income	**17.3**	17.0	0.3
Gains/(losses) on asset sales	**0.5**	(0.8)	1.3
Non-interest income	**16.5**	(2.4)	18.9
Operating Income	**34.3**	13.8	20.5
Direct costs	**(6.2)**	(17.8)	11.6
Impairment gains/(losses) on loans and advances	**0.2**	2.1	(1.9)
Contribution result	**28.3**	(1.9)	30.2

	2016 £m	Re-presented 2015 £m	Change £m
Assets	**7,891.9**	8,628.8	(736.9)
Liabilities	**3,992.3**	4,137.9	(145.6)

Treasury and Other contributed £28.3m in 2016 compared to a contribution of (£1.9m) in 2015.

Net interest income remained broadly flat rising from £17.0m in 2015 to £17.3m in 2016.

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

Non-interest income was £16.5m in 2016 compared to a net expense of £2.4m in 2015. The increase in non-interest income was mainly due to a gain of £15.9m on the sale of AFS gilts held as a hedge for the LME subordinated debt issuance. The LME subordinated debt is now hedged with derivatives. The Bank also ended its participation in the Funding for Lending scheme (final repayment was made in January 2016) and therefore did not incur the same fees as in 2015. In addition, there was a negative variance due to ineffectiveness in hedge accounting.

Non-core

Non-core balance sheet

	2016 £m	Re-presented 2015 £m	Change £m
Legacy Portfolio	**1,471.4**	2,034.3	(562.9)
Optimum	**2,838.4**	3,109.8	(271.4)
Assets	**4,309.8**	5,144.1	(834.3)
Legacy Portfolio	**61.3**	282.7	(221.4)
Liabilities	**61.3**	282.7	(221.4)

	2016 £m	Re-presented 2015 £m	Change £m
Customer assets	**4,075.4**	4,898.9	(823.5)
Customer liabilities	**61.3**	282.7	(221.4)

Non-core total assets decreased from £5.1bn in 2015 to £4.3bn in 2016. The level of deleverage of Non-core assets year on year has reduced significantly as the Bank did not undertake any further securitisation of the Optimum portfolio in 2016. The Bank has however continued to dispose of Legacy Portfolio assets in 2016.

In February 2016, £0.4bn of Private Finance Initiative and Renewable Energy and Asset Finance assets were transferred from the Legacy Portfolio into BaCB. Following further management review of the go forward SME Banking strategy in H2, these assets have transferred back and are once again included in the Legacy Portfolio at the reporting date. These assets contributed £4.6m of net interest income in 2016 to BaCB.

Optimum, the Bank's Non-core residential mortgage portfolio, reduced from £3.1bn to £2.8bn in 2016, driven by customer capital repayments.

Non-core customer liabilities have reduced from £282.7m in 2015 to £61.3m in 2016. As the Bank continues its Legacy Portfolio deleveraging strategy, customers have continued to migrate to other financial institutions.

Non-core contribution

	2016 £m	2015 £m	Change £m
Net interest income	**(17.9)**	10.9	(28.8)
Losses on asset sales	**(14.0)**	(120.6)	106.6
Non-interest income	**9.5**	17.5	(8.0)
Operating loss	**(22.4)**	(92.2)	69.8
Direct costs	**(9.4)**	(14.8)	5.4
Impairment (losses)/gains on loans and advances	**(2.2)**	48.9	(51.1)
Contribution loss	**(34.0)**	(58.1)	24.1

Non-core contributed a loss of £34.0m in 2016, compared to a loss of £58.1m in 2015.

Non-core net interest income has decreased by £28.8m, following a continued reduction in interest generating assets reflecting the significant deleverage delivered from the start of 2015.

The 2016 Non-core loss on sale of £14.0m is £106.6m lower than 2015 due to lower volumes of Legacy Portfolio deleverage and cessation of Optimum sales.

The reduction in Non-core contribution is further impacted by a £2.2m net impairment charge on loans and advances in 2016, down from a net write-back of £48.9m in 2015. The significant net write-back in 2015 was driven by assets being disposed or revalued at favourable prices to their net book value resulting in the write-back of previously recognised impairment provisions.

Non-core non-interest income is down on 2015 as a result of lower asset balances across the business and will continue to fall as the Bank continues to deleverage its asset base.

Direct costs reduced by £5.4m to £9.4m in 2016, primarily as a result of a reduction in staff costs, with significantly fewer staff being required as the book is deleveraged.

Outlook
This outlook should be read in conjunction with the Principal Risk and Uncertainties section, the Going Concern disclosures in note 1 of the financial statements and the forward looking statements section on pages 254 to 255.

The Bank's announcement on 26 January 2017 noted that the Bank expected its CET1 ratio (in the absence of any management actions) to fall and remain below 10% over the medium term and that it was unlikely to meet its Individual Capital Guidance (ICG) over the planning period to 2020. In addition, the Bank reported that it continued to expect to meet its Pillar 1 capital requirements and to maintain sufficient liquidity to meet its obligations.

The Bank's announcement on 13 February 2017 noted that the Bank has always been clear that, although it met Pillar 1 regulatory capital requirements and expected to continue to do so, it needed to build its capital and meet longer term UK bank regulatory capital requirements. This announcement continued by noting that its capacity to do so organically had been constrained by (i) the impact of interest rates that are lower than previously forecast, reducing the Bank's ability to generate income, and (ii) higher than anticipated transformation and conduct remediation costs. The announcement also noted that the Bank has also needed to consider enhanced regulatory capital and MREL[6] requirements expected of all UK banks.

As a result, and having concluded its annual planning review, the Bank announced the commencement of a sale process, inviting offers for all of its issued ordinary share capital, and that it was considering ways of raising equity capital from existing and new capital providers and a potential liability management exercise of its outstanding public debt.

As an alternative to a sale, the Bank's Plan seeks to raise an additional £700m to £750m of CET1 resources. Whilst the structure, terms and timing are to be finalised, this may be achieved via a liability management exercise involving the potential exchange of the Bank's debt securities to equity (taking into account the Bank's creditor hierarchy) alongside an additional primary equity capital raise of approximately £300m to enable the Bank to achieve CET1 ICG[4] compliance from 2017 onwards. Furthermore, assuming the successful completion of such capital raise, the Bank is anticipating circa £250m Tier 2 issuance during 2018 and further MREL qualifying debt issuances in 2020/21. If all of these measures are implemented as planned, the Bank expects to be fully ICG[5] compliant from 2018 and meet all capital and interim MREL requirements in 2019.

2017 Outlook and Longer Term Targets
On the basis that the above Capital Raising[7] activity by the Bank is implemented as planned, and that the Bank is also otherwise able to implement the Plan as expected, the Bank is targeting the following:

	2016 Reported	2017 Outlook	Longer Term Targets
Balance Sheet			
Retail and Business Banking Customer Assets	£15.3bn	Broadly flat	c. £1bn net growth per annum
Other Assets	£12.3bn	c. £10bn	Reduce with Legacy Portfolio run-off
Income Statement			
NIM[1]	1.39%	-	Increasing from 2018, with increasing base rates, up to 10bps per annum
Non-interest income	£67m	-	c. £40m per annum
Operating costs	£445m	c. £410m	c. £350m per annum targeted from 2018
Project costs	£310m	c. £160m	Run rate of c. £50m per annum over the medium term
FV Unwind	£181m	£60m final unwind	-
RoE[2]	n.m.	n.m.	Strong single digit in 2021[3] with material progress by 2019
Capital			
RWAs	£6.7bn	c. £6.0bn	Broadly stable
CET1 ratio	11.0%	-	22-23% to comply with all regulatory requirements
Pillar 2a and ICG	14.5% of RWAs	CET1 ICG[4] compliance	Full ICG[5] compliance with c.£250m Tier 2 issuance[8] in 2018
Excess Capital	n.m.	n.m.	PRA Buffer[5] compliance in 2019 with potential for 2020 dividend[9]
MREL	n.m.	n.m.	MREL[6] issuance[8] in 2020/21

1. Calculated based on average total assets
2. Profit after tax over average total equity
3. Based on a capital stack that meets all capital requirements
4. Equivalent to 75% of Pillar 1 and Pillar 2a as 19% of AT1 requirement to be met with CET1
5. Based on the Bank's internal assessment of future Pillar 2a and 2b requirements. Subject to future SREPs
6. Per statement of policy on the Bank of England's approach setting MREL (November 2016) (http://www.bankofengland.co.uk/financialstability/Documents/resolution/mrelpolicy2016.pdf).
7. For significant execution risks and material uncertainties regarding successful completion of the Capital Raising, which may not be completed on acceptable terms, or at all, see 'Principal Risks and Uncertainties' section.
8. Tier 2 and MREL issuance depends on Capital Raising, Bank credit rating improvement and conducive prevailing capital markets. Issuance may not be completed on acceptable terms, when needed or at all.

9. Subject to regulatory capital requirements, including CRR Maximum Distributable Amount restrictions on dividends and distributions, PRA approval and the availability of distributable reserves. The availability of distributable reserves is expected to require a shareholder and court approved reduction of share capital.
10. Subject to shareholder, bondholder and other approvals. For significant execution risks and material uncertainties regarding successful completion of the Capital Raising, which may not be completed on acceptable terms, or at all, see 'Principal Risks and Uncertainties' section.
n.m. refers to not meaningful

As at 31 December 2016 the Bank's ICG Pillar 2a requirement was 14.49% of RWAs, which equated to a capital requirement of £967.4m. The Bank believes its Pillar 2a requirement should reduce materially over time and has a target end state of c. 9.5% of RWAs[5]. The targeted reductions are expected to be driven by:

- operational risk requirements decreasing, as conduct issues are remediated and the risk of business disruption from operational events, including system failures, is reduced;
- execution risk decreasing as the Bank completes its transformation programme;
- Interest Rate Risk on the Banking Book (IRRBB) decreasing as retained Warwick notes expected to mature in June 2020;
- reduced model risk requirements as the Bank's IRB remediation programme concludes, supporting add-on removal; and
- the outcome with regards to the Pace separation negotiations.

There are significant execution risks and material uncertainties regarding successful completion of the Capital Raising, which may not be completed on acceptable terms, or at all. See Principal Risks and Uncertainties section on pages 35-48.

DETAILED KEY PERFORMANCE INDICATORS

The key performance indicators presented below[1] reflect the way in which the performance of the Bank has been measured during 2016. Management continues to review these measures on an ongoing basis.

Capital KPIs

	Definition	Why it is important for the business and management	
CET1 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 Bank must have a CET1 ratio of at least 6% in order to meet Pillar 1 capital requirement.	2016: 11.0% 2015: 15.5%
Total Capital Ratio	The ratio of total capital resources to the Bank's total RWAs.	The Bank is required to maintain minimum regulatory capital and capital ratios at all times. The total capital ratio is important for the Bank's ability to withstand any future market wide or individual stresses.	2016: 17.7% 2015: 21.6%
Leverage Ratio	A ratio calculated by reference to CRD IV Tier 1 capital (after deductions) divided by adjusted balance sheet exposure.	Under UK leverage ratio framework, a 3% minimum leverage ratio requirement applies to firms with retail deposits greater than or equal to £50bn from 1 January 2016 onwards. While the Bank does not currently have a minimum leverage ratio requirement, it continues to assess its leverage ratio against broader UK requirement.	2016: 2.6% 2015: 3.8%
Total RWAs	RWAs are required to be calculated for the Bank to provide for three types of risk: i Credit risk. ii Market risk. iii Operational risk. The Bank considers market risk within credit risk. The Bank's capital ratios are calculated from the sum of the three RWA categories.	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.	2016: £6.7bn 2015: £7.4bn

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.	2016: (£477.1m) 2015: (£610.6m)
Net interest margin[2]	Net interest income (the difference between interest received from loans/other assets and interest paid out on deposits/other liabilities) divided by average total assets.	The net interest margin is the key measure of the Bank's ability to generate revenue.	2016: 1.39% 2015: 1.42%
Cost:income ratio	The proportion of the Bank's revenue which is used to fund its operating costs calculated by dividing operating costs plus operational projects (including the associated depreciation) by operating income excluding losses on asset sales.	A principal measure of the efficiency of the Bank's overall operations.	2016: 103.7% 2015: 100.0%

1. KPIs are calculated on a management accounts basis as this is how we manage our business.
2. Net interest margin is calculated as net interest income divided by the average of the opening and closing asset balances for the period.

HR Key performance indicators

	Definition	Why it is important to the business and management	
Colleague engagement	The Bank measures the engagement level of its employees based on responses to questions covering five areas. This is a measure of colleague sentiment towards the Bank based on their advocacy, confidence, commitment, pride and their willingness to give discretionary effort that supports productivity and performance.	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 delivering the 2017-2021 Strategic Plan.	2016: 64% 2015: 66%

Gender diversity

YE 2016	Female No.	Female %	Male No.	Male %
Board[1]	2	17%	10	83%
Executive Management Team[2]	3	33%	6	67%
Other employees	2,517	59%	1,728	41%
Grand total	2,522	59%	1,744	41%

YE 2015	Female No.	Female %	Male No.	Male %
Board[1]	2	18%	9	82%
Executive Management Team[2]	2	22%	7	78%
Other employees	3,078	61%	1,988	39%
Grand total	3,082	61%	2,004	39%

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

The definitions used for reporting in this section have been updated to ensure consistency of approach across Bank reporting. The 2015 categories are in line with ICSA: The Governance Institute guidance for the content of an annual report for UK companies.

Core Bank KPIs

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

	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.	2016: 1.78% 2015: 1.89%
Customer deposits	The amount of money customers hold in their accounts with the Bank, also known as customer liabilities.	The Core Bank needs customers to deposit money with the Bank so that it is able to fund loans to other customers.	2016: £22.1bn 2015: £22.4bn
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.	2016: £15.3bn 2015: £14.7bn
Primary current account holders	Customers holding an account with the Bank who on average pay in £800 or more per month.	A measure of the size of the Core Bank's active customer base.	2016: 664,268 2015: 655,965
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.	2016: £3.9bn 2015: £3.7bn
Total current account holders	The total number of open current accounts the Bank has.	Current accounts are the cornerstone of the Bank's relationship strategy.	2016: 1,435,470 2015: 1,431,323

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.	2016: £4.1bn 2015: £4.9bn
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.	2016: £2.0bn 2015: £2.8bn

PRINCIPAL RISKS AND UNCERTAINTIES

This section summarises the principal risks and uncertainties facing the Bank and how they are being managed or mitigated. This is not a comprehensive description of all the risks and uncertainties facing the Bank. It is comprised of three sections:

- 'Background and the Bank's 2017-2021 Strategic Plan' (the Plan) provides the context in which the Bank's principal risks and uncertainties should be understood and includes an overview of the principal risks and uncertainties relating to important management actions which form part of the Plan and upon which success of the Plan depends;

- 'Regulatory Deficiencies' summarises the Bank's deficiencies against regulatory requirements and expectations which constitute principal risks and uncertainties; and

- 'Other Key Risks' outlines other key financial and non-financial risks and uncertainties as identified by the Bank's Risk Management Framework (RMF) and how they are being managed or mitigated. These are linked to the Bank's RMF risk taxonomy: see further 'Risk Management – section 1.4 Principal Risk Categories'.

1. Background and the Bank's Plan

The Bank required a £1.5 billion recapitalisation in December 2013 enabling a turnaround plan to be started. Although the Bank has since made considerable progress in implementing its turnaround plan, the Bank's capacity to build its capital to meet current and future UK bank regulatory capital and loss absorbing requirements has been constrained principally by the impact of lower interest rates that are forecast to remain lower for longer than previously forecast and by higher than expected transformation and conduct remediation costs. To address these issues, as part of its annual review process relating to the 2016 financial year and concluding its annual planning process, the Bank recently finalised its Plan for 2017-2021, which we refer to as the Plan.

The Board has announced a proposed sale of the Bank, which may or may not result in a committed offer to acquire the Bank. The Plan approved by the Board and accepted by the PRA anticipates various important management actions, including, as an alternative to a sale of the Bank, successfully raising between £700m and £750m of additional CET1 resources from existing and new capital providers to raise sufficient CET1 to meet the CET1 component of the Bank's future ICG regulatory capital requirements. The structure, terms and timing of this CET1 capital raising are being finalised though it may include a liability management exercise or other restructuring (LME), involving exchanging certain classes of the Bank's bonds into equity (taking into account the relative ranking of these bonds in the Bank's creditor hierarchy) alongside a potential primary equity capital raising. We refer to these CET1 capital raising actions as the Capital Raising. The PRA has accepted the Bank's Plan and the PRA intends to closely monitor the Bank's performance against it. There is a risk that the Bank does not successfully deliver all or part of the Plan when planned or targeted. Failure to successfully implement, or a delay in implementing, the Plan and completing the Bank's turnaround transformation plan may adversely affect the Bank's business, operating results, financial condition, prospects, regulatory capital position and its ability to comply with its regulatory capital requirements.

Going Concern Uncertainty

As the Bank has disclosed in its financial statements for the past 3 years, its financial statements (see Note 1.2 to the Bank financial statements) indicate, and the audit report on those financial statements contain an 'emphasis of matter' statement, indicating that there are material uncertainties which may cast significant doubt on the Bank's ability to continue as a going concern.

Risks relating to the sale of the Bank and Capital Raising

In the near term, these material uncertainties are principally the significant execution risks and material uncertainties regarding a successful completion of a sale of the Bank or a Capital Raising. The structure, terms and timing of a sale or Capital Raising is being finalised, though the Bank has engaged financial and other advisers to assist and advise on these matters. Successful completion of a sale or Capital Raising may depend on greater certainty on the scale of future pension obligations, which may be difficult to resolve in the short term and the PRA expects the Bank to seek to advance negotiations with The Co-operative Group and the Pace trustee. Completion of a sale or Capital Raising are each subject to a number of uncertainties beyond the control of the Bank including obtaining requisite regulatory, shareholder and bondholder approvals, the agreement and signing of definitive documents on acceptable terms and conducive market conditions.

Any sale of the Bank is subject to risks and uncertainties. These include, for example:

- whether there are any willing purchaser(s) that are acceptable to our shareholders and other stakeholders that can and will buy the Bank when needed, on terms acceptable to our shareholders and other stakeholders, or at all;

- whether any purchaser (or group of purchasers) will be able to raise or restructure any financing that is necessary to complete the purchase of the Bank, when needed on acceptable terms, or at all;

- whether any purchaser will obtain any necessary regulatory or other approvals to complete the purchase of the Bank on acceptable terms to the purchaser, or at all; or

- whether a purchaser (or group of purchasers) that acquires the Bank is able to successfully integrate the Bank into its operations and do so in a manner consistent with the values and ethics of the Bank. Failure to do this could negatively impact the Bank's brand and business.

In addition to announcing that it was starting a sale process, the Bank also announced that it is also considering the Capital Raising to mitigate against the risk and uncertainties that the Bank may not be sold, or that any sale may be delayed. The principal risks and uncertainties relating to the Capital Raising include: whether the Capital Raising will raise sufficient CET1 capital, on acceptable terms, when needed, or at all; the Bank's ability to complete any primary equity raising component of the Capital Raising following a failure, or perceived failure, to sell the Bank; which classes of the Bank's bondholders (having regard to the creditor hierarchy) will be included in the LME; the failure of the requisite majorities of shareholders, bondholders or creditors to approve and/or participate in the LME and/or equity raising components of the Capital Raising or the failure to obtain any other regulatory, court or other approvals necessary to complete the Capital Raising, when required, or at all; regulators concluding that the amount of CET1 capital actually raised in the Capital Raising is insufficient to meet the Bank's regulatory capital requirements; the Bank becoming involved in disputes and legal proceedings that prevent or delay successful implementation of the LME or primary equity raising, or disputes that render it unlawful and invalid, or are very costly, resulting in a requirement for the Bank to raise further CET1 capital.

There are significant execution risks that the Bank may not complete a sale of the Bank or a Capital Raising on acceptable terms, when needed, or at all. There is a risk that, if both the sale of the Bank and Capital Raising fail, the Bank will be unable to achieve the management actions and targets in the Plan, including the '2017 Outlook' targets and 'Longer Term Targets' outlined in 'Detailed Financial Review: Outlook', unable to become ICG compliant as expected in the Plan and, therefore, fail to deliver its Plan successfully. If the Bank is unable to successfully deliver its Plan (or its delivery is delayed in whole or in part); then the Bank's regulators have the discretion to exercise one or more of various powers over the Bank. They can agree a revised plan, require some other actions to be taken on the part of the Bank or, in the absence of any of these, the FCA and/or PRA may vary or restrict the Bank's permissions or business, and the Bank of England may impose particular directions or a special resolution procedure on the Bank under the Banking Act 2009 [1]. A special resolution procedure is likely to have a significant adverse effect on some or all of the Bank's existing and future shareholders, bondholders (whether or not those bondholders are included in any LME), customers and colleagues.

If the sale of the Bank does not proceed but a Capital Raising is successful, it is still anticipated that the Bank would need to undertake further capital market issuances, including approximately £250m of Tier 2 capital and further MREL debt issuances, over the life of the Plan. There is a risk that the Bank may be unable to complete these issuances in the amounts or when planned or required by the Bank's regulators, on acceptable commercial terms, or at all.

Risks of Sale/Capital Raising uncertainties on the Bank's reputation and business
In the meantime, the uncertainties surrounding whether or not the Bank will be sold and, if sold, to whom and related press speculation about the Bank's future (and the success or failure of the sale or Capital Raising), may damage the Bank's brand and reputation. Such reputational damage may negatively impact our ability to attract and retain Retail deposits, customers, colleagues and suppliers, and, therefore, may have an adverse effect on customer and investor confidence, the Bank's business, operating results, financial condition, its prospects and the Bank's ability to successfully deliver the Plan. The Bank's strategy is based in part on the Bank's reputation as being fairer, more responsible and trusted than its competitors. This reputation may be undermined by any change in ownership of the Bank resulting from any sale or the Capital Raising.

Risks relating to the other key assumptions in the Plan
In addition to the risks and uncertainties regarding a sale of the Bank or Capital Raising, there is a risk that the Bank may fail to successfully deliver other management actions and parts of its Plan, when planned or targeted. The key assumptions underlying the Plan include:

Net interest margin
The Plan targets steady increases in the Bank's net interest margin, in line with forecasted interest rate increases assumed to begin in 2018, of up to 10bps per annum. These targets are most susceptible to interest rate changes and competitive pressures. Lower for longer interest rates will restrict the Bank's ability to increase net interest margin and, consequently, restrict organic capital generation and profitability, as well as improvement in cost:income ratios. The Plan also assumes our market share in new business mortgage assets is preserved, allowing the Bank to significantly increase prime residential mortgage asset volumes in Retail and Platform over the life of the Plan, and that unsecured loan and credit card balances decrease from 2017. The personal financial services industry is mature, so growth often requires taking market share from competitors. The Bank faces risk of losing market share to other banks, building societies and insurance company competitors, which may impact the Bank's plans to increase Bank profitability based on preserving its market share of new mortgage origination and other products over the life of the Plan. There is a risk that base rates may not increase as soon or as much as forecast, that competitive pressures reduce the Bank's market share or do not enable margins to increase as planned or that regulatory pressures constrain the anticipated growth in volumes. The Plan assumes asset pricing increases across the market generally as a result of the lower for longer interest rate environment, generating fewer available options for retail banks to deliver improved net interest margin. If, and to the extent that, these increases are not forthcoming as assumed in the Plan, then the Bank's actual net interest margin trajectory could be significantly lower than targeted.

Increasing mortgage sales
The Plan targets growing the Bank's net core customer assets by approximately £1 billion in each year of the Plan, primarily driven by the Bank's Platform brand. There is a risk that the growth of these assets is significantly less than planned, that new mortgage origination may be significantly less than expected due to any number of internal or external factors, e.g. a possible contraction of the UK mortgage market, or that mortgage origination may be disrupted if the Bank's mortgage process outsourcer is unable or unwilling to perform its services and/or that the pressure to achieve the targeted increases may create new conduct, legal and regulatory risks. There is also a risk that the Bank may be unable to maintain access at an appropriate cost to liquidity and funding to fund the requisite level of asset origination targeted in the Plan, including a risk that the Bank may be unable to gain access to current or future central bank funding facilities and initiatives.

Reduced losses on asset sales
The Plan assumes reduced losses on the sales and deleverage of the Bank's Legacy Portfolio business in 2017 and no further material losses on other assets sales. There is a risk that any remaining asset sales may not be completed on acceptable terms, or at all, or may result in greater unprovided losses than planned (or be delayed).

Non-interest income
The Bank's non-interest income has decreased in recent years to £66.7m in 2016, principally as a result of the reduction in the Bank's ATM network and lower rates on merchant interchange. The Plan targets non-interest income remaining broadly stable at approximately £40m per annum for the life of the Plan. Within this it is assumed there is an increase in fees for certain liability products in order to achieve this. Changes in the fees could result in higher than anticipated out flows of customer deposits and the need for the Bank to replace these out flows with more expensive funding sources, further decreasing net interest income more than assumed in the Plan and/or lower than expected overall non-interest income.

Transformation Programme Delivery
The Plan assumes the Bank is able to deliver the remaining transformation, remediation and change programmes and the cost reduction initiatives already underway without material deviation from planned timescales and costs. The Plan targets operational, remediation and strategic project expenditures reducing from £310m in 2016 to approximately £160m in 2017 and then targets project costs of approximately £50m per annum over the medium term: significant targeted reductions from the Bank's project costs of recent years. Historically, the Bank has experienced significant cost overruns when implementing complex large-scale change projects, and some projects have not delivered the planned benefits. Any deficiencies in appropriate governance and related programme management processes to assist with the satisfactory delivery of these activities would have an adverse effect on the Bank's operating results and financial condition compared with those targeted in the Plan. There are risks that the Bank may be unable to complete this programme when planned, and that it may cost significantly more than targeted or have a reduced scope for the same targeted costs, or deliver less benefits than planned, thereby impacting associated cost reductions or income generation plans.

Lower cost:income ratio
The Bank's continuing high cost:income ratio, partly as a result of prior issues with the Bank's turnaround plan, inhibits the Bank's profitability and may hinder its ability to raise new capital. The Bank is expected by the PRA to demonstrate that it has the means and ability to deliver in the medium term an acceptable cost:income ratio. The Plan therefore targets operating costs reducing from £445m in 2016 to approximately £410m in 2017, further reducing to a long term target of £350m per annum from 2018. These operating cost reduction targets assume that the Bank successfully effects significant cost reduction initiatives in the near term and that operating expenditure and project costs, including remediation, integration and resiliency projects, are significantly lower during the remaining years of the Plan than in recent years. There is a risk that the Bank may be unable to achieve these intended cost reductions, when planned, or at all. Operating costs may be higher than expected, particularly in the latter half of the Plan. There is a risk that the Bank's cost:income ratio continues to negatively impact its profitability and its capital position.

Conduct Provisions and Legal Risks
In the three years ended 31 December 2016, there have been total conduct risk charges of £319m. The Plan assumes no significant new conduct or legal risk provisions during the planning horizon. There is a risk that the Bank becomes exposed to significant new conduct or legal risks, either by the Bank discovering significant new conduct and legal risk issues from the Bank's legacy systems and controls or from regulatory changes imposed on banks generally or on the Bank in particular. Conduct provisions for PPI and other known issues, as well as new conduct and legal risk issues that may emerge during the life of the Plan, and related remediation and project costs, may be much higher than expected over the life of the Plan.

Risk Weighted Assets (RWAs)
The Plan targets RWAs falling to approximately £6.0bn by the end of 2017 and then targets RWAs remaining broadly stable over the life of the Plan. RWAs may be significantly greater than targeted due to worsening economic conditions (e.g. higher unemployment and lower property prices could result in higher levels of impairments) and any material increases in RWAs will significantly increase our capital requirements beyond those planned for. The RWA targets assume remediation of the Optimum portfolio temporary adjustment (mentioned below in 'Optimum portfolio Risk Weighted Assets temporary adjustment') and further deleverage of the Legacy Portfolio resulting in the losses assumed in the Plan. If either of those actions is unsuccessful, RWAs could remain higher than those targeted in the Plan, resulting in greater capital requirements than anticipated and lower CET1 ratios than targeted.

Other planned capital markets issuances
The Plan targets further capital issuances starting with approximately £250m Tier 2 debt issuance in 2018, and MREL qualifying debt issuances in 2020 and 2021, assuming that, if the sale of the Bank does not proceed, the Capital Raising is successfully completed. There are risks that the Bank will be unable to raise the required capital on acceptable terms, when planned or at all and, that the Bank will be unable to achieve ICG compliance when planned, or at all. See 'Anticipated Regulatory Capital Requirements' below.

Continued regulatory support
The Plan assumes that the PRA and other regulators continue to be supportive of the Bank's current inability to meet the regulatory requirements discussed under 'Regulatory Deficiencies' and 'Other Key Risks - Regulatory Risk and Conduct Risk' below. There is a risk that the PRA or other regulators may exercise their discretion to withdraw their support for the Bank at any time.

Pension Funding Requirement
Given the uncertainty that remains around separation of the Bank's liability to the Pace pension scheme, the Bank's Plan makes a non-binding assumption for planning purposes that the Bank continues to provide a £5m per annum contribution to the Pace pension scheme deficit. There is a risk that the Bank may be required to pay significantly more than assumed in the Plan as a result of

- the 'last man standing' clause should one or more participating employers fail;

- contribution negotiations in the absence of Pace separation (for example, in the context of the 5 April 2016 Pace valuation currently underway); or

- the outcome of PACE separation negotiations.

In addition, the Bank may be required to fund an increased level of deficit in connection within the Britannia pension scheme depending on the outcome of the next triennial valuation. See further section 3.10 'Pension Risk' below.

Ability to Pay Dividends
The Bank does not expect to pay dividends in the near future (see 'Directors' Report'). The Bank's ability to pay any dividends at any time in the future is subject to the Bank's compliance with regulatory capital requirements, including CRR Maximum Distributable Amount restrictions on dividends, distributions and variable remuneration, PRA approval and the availability of distributable reserves. In addition, the availability of distributable reserves is expected to require a shareholder and court approved reduction of share capital.

Return on Equity (ROE) targets
The targeted ROE relies on the Bank's ability to successfully mitigate the risks outlined above, particularly the Bank's ability to widen net interest margin and develop its interest income and deliver the anticipated cost reduction and resulting cost:income ratio. If any of the risks above do materialise, this may result in lower future returns and a lower than targeted ROE.

A failure or delay in implementing these other important parts of the Bank's Plan may adversely affect the Bank's business; operating results, financial position, and prospects; and, its regulatory capital position and ability to comply with its regulatory capital requirements.

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

- lower interest rates that remain lower for longer than forecast;
- whether assets in the Bank's Legacy Portfolio can be sold on acceptable terms, or at all;
- deterioration in general economic conditions, instability of global financial markets including the effect of macro political conditions in Europe (including forthcoming elections in certain EU member states and the unresolved Euro sovereign debt issues);
- the UK's impending departure from the EU, which may occur as early as April 2019;
- possible contraction of the UK mortgage market negatively impacting loan book growth;
- systemic capital markets volatility;
- UK banks' reaction to the Bank of England stimulus package (base rate, gilt purchases, Term Funding Scheme);
- higher unemployment and lower property prices increasing impairments;
- further clarity around future regulatory requirements, including expectations regarding MREL requirements[2];
- the management of credit risk, interest rate risk, currency risk and market risk;
- risks stemming from regulatory change, increasing regulatory enforcement and an increasingly litigious environment; and,
- the impact on the Bank's operating results, financial and capital position of the implementation of accounting standards and interpretations, including, with effect from 1 January 2018, IFRS 9 on the Bank's accounting of financial assets and liabilities, impairment of financial assets and hedge accounting.

The development and implementation of the Plan, including the '2017 Outlook' targets and 'Longer Term Targets' outlined in 'Detailed Financial Review: Outlook', required difficult, subjective and complex judgements including targeted effects of management actions, assumptions, projections and forecasts of economic conditions and other conditions beyond the control of the Bank. Subjective and complex judgements were also involved in the Plan forecasts and assumptions regarding such key performance indicators as: net interest margin, cost:income ratio, CET1 ratio, leverage ratio and RWAs. If, and to the extent that, these judgements prove to be incorrect there is a risk that the Plan may not sufficiently address the Bank's current difficulties or deliver the expected benefits.

2. Regulatory Deficiencies
The following section summarises the principal risks and uncertainties relating to the Bank's position in relation to deficiencies against regulatory requirements and expectations. These deficiencies have existed for some time and will continue for some years to come while the Bank implements its Plan. The successful implementation of the Plan depends upon the ongoing support of its regulators and supervising authorities regarding any continuing and intervening deficiencies to required regulatory standards.

2.1 Anticipated Regulatory Capital Requirements
Although the Bank meets and expects to continue to meet its Pillar 1 capital requirements under CRR, the Bank is not currently compliant with its ICG requirement (the mandatory capital requirement issued to the Bank by the PRA covering the Pillar 2a requirements the Bank is required to hold in excess of Pillar 1). The Plan indicates that, absent of management actions, increased operating losses of the Bank over the Plan period result in an increased deficit to the Bank's projected ICG requirements and defer compliance beyond the life of the Plan. In January, the Bank announced that it expects its CET1 ratio, in the absence of management actions, to fall and remain below 10% over the medium term. As a result, while the Bank continues to expect to meet its Pillar 1 requirements, there is a risk that the Bank's projected headroom above the Pillar 1 regulatory minimum would not be sufficient to enable the Bank to issue MREL qualifying debt on acceptable terms in the significant amounts, and when needed, as indicated by the Bank of England in its non-binding indication of future MREL requirement to the Bank. The Bank does not currently have sufficient capital resources to withstand a severe stress scenario under its current in force PRA buffer.

To mitigate that risk, the Plan, therefore, contemplates that the Capital Raising would raise a significant amount of additional CET1 capital sufficient to help enable the Bank to increase the CET1 component of its headroom above Pillar 1 requirements. The Bank anticipates that if the Capital Raising is successful and the Bank's credit risk capital modelling deficiencies are successfully remedied (see section 2.2: 'Risks Relating to the Bank's Credit Risk Capital Modelling Requirements' below), the Bank will be able to meet its Pillar 1 and Pillar 2a requirements, thereby targeting returning to ICG compliance on a sustainable basis following a Tier 2 capital issuance in 2018. This projected return to ICG compliance is based on the Bank's internal view of the how its ICG requirements will evolve over time and, thus, there is a risk that the PRA could set an ICG requirement different to that which the Bank has assumed in the Plan.

In addition, the Bank's Plan targets MREL qualifying debt issuances in 2020 and 2021 assuming successful completion of the Capital Raising, the Bank becoming ICG compliant as discussed above and improving its profitability as contemplated in the Plan. In the connection with the Bank's former strategic plan that contemplated MREL qualifying debt issuances starting in 2018, the PRA and the Bank of England have indicated their strong preference that the Bank effect an earlier profile of MREL qualifying debt issuance. There is, therefore, a risk that, the Bank may be required to issue MREL qualifying debt earlier than 2020 and 2021 and be unable to do so (whether or not the Bank has successfully completed the Capital Raising and other actions discussed above to return to ICG compliance), in which case the Bank's regulators will be entitled to require the actions or exercise the powers discussed below.

Even if the Capital Raising is successful, the Bank's ability to complete the planned Tier 2 capital and MREL qualifying debt issuances may be dependent on an improvement in the Bank's credit rating from its current sub-investment grade credit rating and conducive capital markets prevailing at the time. There is, therefore, a risk that the Bank may be unable to complete these issuances on acceptable terms, in the amounts and when contemplated in the Plan or when required, or at all.

Given the risks and uncertainties relating to the Capital Raising mentioned in section 1, there is a risk, especially if the Bank is not sold and is unable to successfully complete the Capital Raising, that the Bank may be unable to raise the additional capital and MREL qualifying debt contemplated in the Plan when planned or required, on acceptable terms, or at all.

Whether the Bank is able to meet its ICG during that period will also depend on a number of other factors, within and outside the control of the Bank, including its ability to deliver its Plan, and UK economic and market conditions generally.

If the Bank fails to meet its capital, ICG or MREL requirements or its plan to comply with those requirements, the Bank's Regulators can agree to accept the Bank's original plan, a revised plan, use their respective powers to require some other remediating action on the part of the Bank or in the absence of any of these, the Bank of England may exercise its above-mentioned powers under the Banking Act 2009. See further 'Going Concern Uncertainty' in section 1 above.

CRR requirements apply to the Bank on both a Consolidated basis and on a Solo entity basis. Solo refers to the legal entity that holds a banking licence i.e. the Co-operative Bank plc, while Consolidated refers to the Bank and all of its subsidiaries. Capital Requirements Regulation (CRR) allows banks to apply for a Solo Consolidation permission to include subsidiaries that meet certain criteria within its Solo position. The Bank has received the Solo Consolidation permission; however, it does not cover all of the Bank's subsidiaries (these are referred to as non-Solo entities). As a result of the Bank's Solo CET1 ratio being lower than the Consolidated position, there is a lower projected headroom above its Solo Pillar 1 regulatory minimum as compared to the Consolidated position. The Bank is currently considering options to repatriate CET1 capital from the non-Solo entities to the Solo entity to reduce the CET1 differential and improve the Bank's projected headroom to Pillar 1 regulatory minimum on a Solo basis. There is a risk that if the Bank is unable to identify appropriate options and obtain the requisite regulatory non-objections to complete the capital repatriation to the Solo entity in the amounts and in the time frame proposed, or in its entirety, the Bank may suffer a material erosion of its capital resources. This may result in a breach by the Bank of its regulatory minimum requirements on a Solo basis and before any breach in the Consolidated position.

The Bank's ability to enhance its capital positions to meet regulatory capital and MREL requirements will be kept under close review by the Board, the Bank of England and the PRA, periodically, over the life of the Plan.

There is a risk that, whether or not the Bank is able to successfully complete the sale of the Bank or the Capital Raising and raise the Tier 2 capital and MREL qualifying debt it requires when needed, the Bank's regulators may enforce stricter regulatory capital and MREL requirements on the Bank (whether specifically applicable to the Bank or to banks more generally) or may withdraw their support for the Bank at any time.

The PRA published Policy Statement 27/15 to implement the FPC's UK leverage ratio framework in December 2015. This confirms that a 3% minimum leverage ratio requirement plus systemic leverage buffers, where appropriate, applies to firms with retail deposits greater than or equal to £50bn from 1 January 2016 onwards. Therefore, the Bank does not currently have a minimum leverage ratio requirement. The FPC has

confirmed that it will review its framework in 2017 with the possibility of extending the framework to all firms from 2018. If a minimum requirement is extended to include the Bank in 2018, it is anticipated that the Bank would not meet these minimum requirements. However, assuming a successful Capital Raising, the Plan targets a leverage ratio of 3% or greater by the end of the Plan.

Any formal introduction of current proposals from the Basel Committee to implement floors for Probability of Default (PD), Loss Given Default (LGD) and Credit Conversion Factor (CCF) in retail mortgages could also impact the planned allocation of capital to such assets through the life of the Plan.

2.2 Risks relating to the Bank's Credit Risk Capital Modelling Requirements

The Bank is not fully compliant with the Capital Requirement Regulations (CRR) provisions related to the use of an Internal Ratings Based (IRB) approach to modelling its credit risk capital requirements.

A review by the regulator in 2015 identified areas of non-compliance and inadequate procedures relating to use of the IRB approach requiring improvement and remediation to rectify under supervisory guidance. These areas involved a redesign of model risk policy, redevelopments of the Bank's IRB models and the strengthening of the overall control environment. In March 2016, the Bank received a communication from the PRA levying a CRR-related Pillar 2a capital requirement in the form of a fixed add-on in order to cover these risks. It is the Bank's objective, subject to successful completion of the remediation plan and PRA approval, to have the add-on removed at the end of 2017.

A failure to address CRR non-compliance within this timescale could potentially result in further regulatory action such that the Bank's permission to use an IRB approach could be removed, resulting in the use of a standardised approach to modelling credit risk. This could, among other consequences, expose the Bank to a material increase in the calculation of its RWAs and, given that many of the Bank's regulatory capital requirements are calculated by reference to the Bank's RWAs, there may be a consequent requirement to hold additional capital, the creation of an additional ICG deficit and/or a reduction in the Bank's CET1 ratio and an impact to the Bank's ability to meet its capital, ICG or MREL requirements.

Accordingly, there is a risk that the Bank would require more equity and other forms of loss-absorbing capacity beyond that contemplated by the Plan.

2.3 Optimum portfolio Risk Weighted Assets temporary adjustment

The Bank is seeking to enhance its credit modelling capability in a number of key portfolios due to the inherent weaknesses referred to in 2.2 above; and to meet PRA requirements. A major element of these enhancements to the existing models relates to how the Bank determines RWAs for retail secured mortgages.

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

Following the significant deleverage of the Optimum balances in 2015, the Bank judged it appropriate to reduce the temporary adjustment from £1.0bn to £0.3bn in line with the balance reduction in order to ensure that the Optimum RWAs were more reflective of the underlying credit quality of the reduced size of the portfolio. The Bank intends to remove the remaining £0.3bn of the temporary adjustment to the underlying RWAs shortly.

2.4 Risks Relating to Resilience and Recoverability of Critical IT Systems and Controls

Since early 2014, the Bank has run major programmes of IT remediation, including the migration of IT Infrastructure to an IBM managed service platform. Collectively these programmes have addressed a range of deficiencies in the Bank's IT estate including, notably, the inability to prove disaster recovery capability for all critical business processes. In Q1 2015 the Bank received written confirmation from the FCA that the lack of proven end to end disaster recovery capability constituted a breach of the FCA's Threshold Conditions [3].

As part of the remediation programmes outlined above, the Bank has built resilience into each component of its critical IT infrastructure, proving the Bank's ability to recover its critical services in the event of the failure of any individual component.

The Bank believes that this component-level proof of recoverability, taken in aggregate, delivers a reasonable level of recoverability from a major IT infrastructure failure, e.g. the loss of a data centre.

The migration of the Bank's mainframe and associated systems to an IBM managed environment (announced in January 2015) completed in February 2017. This has significantly improved the Bank's ability to test and demonstrate this recoverability of service. There will be further migrations during the next 12 months as the Bank completes its technology separation from The Cooperative Group.

Whilst IT remediation work will continue through 2017 and beyond, in light of the improvements made in IT risk and controls by the end of February 2017, and with particular reference to the migration referenced above, the Bank has received confirmation from the FCA that they consider the breach of the Threshold Condition has been remediated and the Bank to be compliant with Threshold Conditions.

For more information on the operational risk issues the Bank is exposed to due to historic lack of investment in systems and processes see 'Operational Risk' in section 3.4 below.

2.5 Risks Relating to Weaknesses in the Bank's Risk Management Framework (RMF)
A supervisory review of the Bank's RMF was conducted during 2015 and concluded that further work is required to fully embed the RMF across the Bank. To mitigate against the risk of non-compliance and the operational risks of weak RMF systems of control, since that review, the Bank has taken steps to enhance the RMF. Further work is required to fully embed the RMF to a consistent standard across the Bank. This continues to be a key priority for the Bank during 2017.

The PRA will continue to closely review the Bank's progress throughout the year. A failure to implement an RMF that addresses any remaining material deficiencies could potentially result in the Regulator taking further action and operational risks arising from any continuing deficiencies that may have a material adverse effect on the Bank's ability to implement its Plan.

3. Other Key Risks
The following pages outline the other 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, operating results, financial condition, reputation and prospects. The Bank's RMF categorises these risks and comprises the Board approved segmentation of the risks that the Bank faces. See 'Risk Management' for the four main constituent 'Principal Risks' types in the RMF, how each Principal Risk is defined in the RMF and the risk taxonomy within the RMF (to which we refer in the table below).

	Principal Risks – Definition	Why this is important
3.1	**Credit Risk** The risk to earnings and capital arising from a customer's failure to meet their legal and contractual obligations.	**Managing this risk is a fundamental part of what a bank does.** The Bank's exposure to this risk is reducing as higher risk lending is deleveraged; however, as with all other banks, the Bank remains exposed to macroeconomic and market-wide risks such as issues with the housing market and interest rate changes.
3.2	**Liquidity and Funding Risk** The risk that the Bank is unable to meet its obligations as they fall due or can only do so at excessive cost.	**The Bank is reliant on its Retail deposit base as a major source of funding** and given the relative size of the Bank's Retail deposit base as compared with other sources of funding the Bank is particularly exposed to liquidity risks, as a loss of confidence in the Bank by its customers may result in the loss of a high proportion of the Bank's funding. The Bank monitors actions that it can take to mitigate unexpected retail outflows. These actions are monitored as part of the Bank's contingency funding plan and include (but are not limited to) the sale of secondary liquidity, bi-lateral wholesale funding actions and improving retail pricing. There is a risk that press speculation and commentary may cause a loss in confidence which may erode the Bank's deposit base. The uncertainties and press speculation surrounding the Bank's future may increase this risk, although the Bank's deposit and customer base remained relatively resilient during the difficult and uncertain times of the Bank's 2013 recapitalisation. To mitigate against this risk, the Bank plans to monitor its deposit base and account transfers until the uncertainties dissipate. On 15 February 2017, Moody's announced that it had downgraded the Bank's long term senior unsecured rating to Ca from Caa2 with a developing outlook. On 21 February Fitch downgraded the Bank's long term Issuer Default Rating (IDR) to B- from B with an evolving outlook. The Bank's current ratings are: (see ratings table below) The Bank's current credit ratings continue to result in: • sub-investment grade ratings on the Bank's senior unsecured debt, in turn, leading to a significant reduction in the demand for these types of instrument; • a negative impact on the Bank's ability to access short term unsecured wholesale funding; and • heightened collateral requirements within some clearing systems.

	Long term	Short term
Moody's	Ca	Not prime
Fitch	B-	B

	Principal Risks – Definition	Why this is important
3.3	**Market Risk** Market risk is the risk of loss as a result of the value of financial assets or liabilities (including off balance sheet instruments) being adversely affected by the movement in market prices, interest rates or exchange rates. This loss can be reflected in the near term earnings by changing net interest income, or in the longer term as a result of changes in the economic value of future cash flows.	**Macroeconomic uncertainty created as a result of political changes has introduced increased market risk volatility** to which the Bank is exposed, although the eventual impact of the impending exit of the UK from the EU, the impacts of the new US presidency and forthcoming elections in the EU on market risk remain dependent on uncertain economic outcomes. This places further downward pressures on the Bank's forecast income and ability to generate sustainable capital strength. The Bank's Treasury team manages interest rate risk. More information can be found in the risk management disclosures of the Bank's 2016 Annual Report and Accounts.
3.4	**Operational Risk (including Legal Risk)** The risk of loss resulting from inadequate or failed internal processes, people and systems or external events.	**Operational risk levels remain elevated for the Bank due to a number of specific issues such as manual processes, legacy systems and processes for which remediation continues. In particular:** **The Bank's IT system has been underinvested in for a considerable period of time.** The Bank has continued to improve its IT platforms during 2016 to address historic infrastructure and disaster recovery related issues. In the first quarter of 2017 a large proportion of the Bank's critical services will be supported by technology that will have been migrated to an IBM managed environment. The Bank has received confirmation from the FCA that they consider the breach of IT Threshold Conditions has been remediated and the Bank to be compliant with IT Threshold Conditions. Notwithstanding these improvements in the Bank's core IT infrastructure, other aspects of the IT estate require further remediation, notably the desktop IT environment and the Bank's telephony systems. Furthermore some of the Bank's IT applications remain complex and therefore are susceptible to operational interruptions and inefficiencies. **Many of the Bank's business, operational, reporting and financial processes rely on significant manual processes and intervention** which is inefficient and increases significantly the risk of errors in the Bank's data and financial reporting. The Bank's auditors have classified the weaknesses in the Bank's control environment as a 'pervasive risk to the audit' and 'in excess of what would be considered normal in the banking industry'. (See the 'Independent auditor's report to the members' section in this document). The extensive use of manual processes substantially increases operational risk. Until the controls remediation is complete, there is a significant risk that the Bank's financial statements or related disclosures may be restated (although this risk has decreased during 2016 due to improvements in the Bank's financial control and oversight process) and an increased risk that inadequate risk management could lead to exposures outside the Bank's risk appetite, unanticipated losses and regulatory censure. **The Bank's systems of control have been historically weak.** In 2016 significant progress has been made to meet regulatory expectations in the overall effectiveness and embeddedness of the RMF and Model Risk governance frameworks. Focus through 2017 will be to ensure robust risk and control activities remain an integral part of the Bank's business as usual (BAU) activities. There is an increased awareness of the RMF across the Bank and work continues to further embed all elements. Key activity includes: • Further embedding of the RMF across the Bank through a normalisation process and collegiate working across all three lines of defence; • Completion of the Model Remediation Programme with particular emphasis on Capital Regulation Requirements (CRR) and Internal Ratings Based (IRB) and IFRS 9 model development and approval; and, • Focus on the development of Financial Reporting controls through further investment, reduction in manual interventions and automation of key activities. **The Bank is becoming increasingly dependent on outsourcing contracts and partners** for its critical infrastructure and operational capability, often at significant expense. The Bank is exposed to the risk that any outsourcing arrangements are not properly scoped by the Bank in determining business requirements; that the Bank or the supplier may default on or otherwise seek to avoid its contractual requirements; that the outsourcing is not properly managed by the Bank or

	Principal Risks – Definition	Why this is important
	Operational Risk (including Legal Risk) - continued	delivered upon as expected by the outsourced provider on an ongoing basis. In addition if any of the Bank's key outsourcing partners of crucial services cannot or will not continue to provide the outsourced functions and services for a sufficient time and with provision of adequate assistance to enable transfer to an alternative provider, then the Bank may face significant disruption to its services and functions, reputational damage and possible regulatory scrutiny, which may adversely affect the Bank's operating results and financial condition. **The Bank is in the process of separating from The Co-operative Group.** Through 2017 and beyond the Bank will continue to depend on The Co-operative Group to provide a number of services including critical IT services, personnel, and assets and to on-supply certain services, including data and assets, from third party suppliers. The Co-operative Group may terminate certain critical IT services on twelve months' notice and the Bank is in negotiations for the transfer of intellectual property in certain IT applications currently owned by The Co-operative Group. The Bank is progressively migrating to alternative services providers and contractual arrangements, notably via the migration of the Bank's core technology to an IBM managed environment, but this ongoing separation project is complex and may be more costly and take more time than currently contemplated. Furthermore the replacement arrangements may be more costly than the current arrangements with The Co-operative Group. The Bank also has significant counterparty exposure to The Co-operative Group. **The Bank faces legal, financial and reputational risk where legal proceedings are brought against it,** including as a result of the Bank's day-to-day business activity or encouraged by adverse findings of various investigations into events and activities at the Bank. Liability for damages may be incurred by the Bank where third parties are harmed by the conduct of the Bank's business. The Bank may also face legal, financial and reputational risk if proceedings brought by it against customers or third parties, or third party proceedings or enforcement actions involving other banks, are determined adversely to the interests of banks generally or the Bank. These adverse determinations, for example, concerning the enforcement of mortgages and or other products, or operational practices or documentary deficiencies, may have an adverse effect on the Bank's assets, funding facilities, operating results and financial condition. **Fraud risk:** As with other banks, reflecting the increased use of technology in financial services, the Bank and its customers are at a risk of cyber-attacks including attacks designed to overload the Bank's systems. These risks are accentuated as the Bank increasingly digitalises its products, services, key functions and distribution channels and as cyber-attacks become more sophisticated and prevalent. The Bank remains at the risk that any cyber-attack may result in temporary lack of operational availability of the Bank's systems to its employees and/or customers. The Bank continues to manage fraud risk including cybercrime within risk tolerances to manage any resultant losses and to comply with all relevant legal and regulatory requirements.
3.5	**Reputational Risk** Reputational Risk is the risk of damage to how the Bank's reputation, brand or image are perceived by its internal or external stakeholders as a result of its conduct, performance, or the impact of operational failures or other external issues.	**The Bank considers that its reputation as an ethically led organisation is critical to the success of the Plan** and actively seeks to manage and mitigate the risks that may impact its reputation. There is a risk that regulatory findings and investigations may adversely affect the Bank's reputation. In addition, the Bank's Plan contemplates significant cost savings including branch closures and staff reductions, which increase this risk. The Bank continues to use the Co-operative name and brand and therefore carries the risk that its brand may be damaged as a result of matters affecting The Co-operative Group or other co-operatives. The Co-operative Bank trademark belongs to the Bank. In certain circumstances the Bank's right to use the term 'co-operative' could be challenged or removed. The Secretary of State for Business, Energy and Industrial Strategy may direct the Bank to change its registered name if, in their opinion, it gives so misleading an indication of the nature of its activities as to be likely to cause harm to the public. Further, the FCA has the power to prevent the use of the term 'co-operative', or to take other action regarding the Bank's branding, if the FCA considers this desirable to protect consumers, to promote competition in the interests of consumers or to protect the integrity of the UK financial system. A loss of support from key stakeholders for the Bank's continued use of the term 'co-operative' may result in a risk that these authorities could look to exercise

	Principal Risks – Definition	Why this is important
	Reputational Risk - continued	their powers leading to legal, financial and reputational risk. The Bank manages the risk through its actions and commitment to the established values of the co-operative movement, as demonstrated by the embedding of co-operative values and ethics in its articles of association and its Ethical Policy. This risk may increase depending on any changes in the ownership of the Bank resulting from any sale of the Bank or Capital Raising; particularly should The Co-operative Group see its shareholding decrease and as a result reduce its support for the Bank's continued use of the term 'co-operative'. The Co-operative Group also to some extent links its support for the Bank maintaining the term 'co-operative' to the Bank's involvement in The Co-operative Group's membership scheme. The Bank's broader participation in that membership scheme has been under discussion, which discussions The Co-operative Group has put on hold while it awaits further clarity on the future ownership of the Bank. Should these discussions not re-start or should the Bank not participate in the membership scheme, it may increase the risk of a loss of support from The Co-operative Group for the Bank's continued use of the term 'co-operative'. The Bank and The Co-operative Group entered into branding co-existence principles in 2013 and had been negotiating a more detailed agreement which has not been finalised. The Bank continues to liaise with The Co-operative Group regarding use of trademarks and intellectual property relating to the brand where some trademarks used by The Co-operative Group are owned by the Bank and vice versa. Further, the Bank has applied to register 'The Co-op Bank' as a trademark. The Co-operative Group has objected to that registration, and this forms one of the matters on which the Bank continues to liaise with The Co-operative Group. If consensual outcomes are not agreed, this could lead to potential legal, financial or reputational risk for the Bank.
3.6	**Strategic and Business Risk** Strategic Risk is defined by alignment to the CRD IV definition of Business risk, as any risk to a firm arising from changes in its business, including: a) the acute risk to earnings posed by falling or volatile income; and (b) the broader risk of a firm's business model or strategy proving inappropriate due to macroeconomic, geopolitical, industry, regulatory or other factors.	**The principal risks and uncertainties relating to the Bank's Plan and current strategy are summarised in section 1 above.**
3.7	**People Risk** People Risk is defined as the risk associated with inappropriate employee behaviour, inadequate resource (people, capability and frameworks), resulting in customer or financial detriment, and/or legal or regulatory censure.	**Retention of Bank personnel remains a significant risk for the Bank** and is currently heightened by the inability to use variable pay to reward performance, budgetary constraints limiting changes to fixed pay, headcount reductions and ongoing pressure on cost reduction. Whilst employee engagement levels remained relatively stable over the course of 2016, employee confidence in the future of the business declined. Reassuringly the significant majority of the employees believe in the Bank's values and are therefore willing to make an increased effort to support the Bank, but do not feel involved. Staff retention and engagement will be a significant challenge for the incoming executive team. The Bank began a number of key initiatives during 2016 to tackle some key issues relating to people risk. The Bank's Culture Programme sought to improve colleague engagement, reinforcing the Co-operative Bank Values and Culture and embedding these into employee policies and processes. The Emerging Talent strategy advanced in 2016 with the introduction of the summer internship programme, apprenticeships and the continuation of the graduate scheme. The Bank has made considerable progress in strengthening its talent profile and senior level succession planning has made considerable improvement, although ongoing structural changes will impact on succession planning strength. If senior executives or management leave the Bank earlier than planned, the Bank may struggle to replace them with appropriate and sufficiently skilled candidates in a timely fashion, exposing the Bank to operational disruption and potential delay in essential activities necessary for the Plan to be successfully delivered. The requirements of CRD IV affecting variable remuneration may drive higher fixed costs or impact recruitment and retention of staff until the Bank is compliant with its ICG and PRA buffer.

	Principal Risks – Definition	Why this is important
3.8	**Regulatory Risk** Regulatory Risk is defined as the risk that the Bank and subsidiaries breach the letter and spirit of relevant laws, regulations, codes of practice or standards of good market practice.	**Along with the wider banking industry, the Bank must comply with multiple regulatory changes** which may add complexity to an already difficult technology, operational and prudential change programme. There is also a risk that, both foreseen and unforeseen, changes to regulatory requirements affect the Bank's ability to successfully implement its Plan or that the acceptance by regulatory authorities of the Bank's plan to address the various ways in which the Bank is currently non-compliant and which is essential for the Bank to continue to operate, is withdrawn. Changes to regulatory requirements could result in additional compliance costs and diversion of management time and resources. The principal risks arising from the regulatory position of the Bank, including the Bank's compliance with ICG and CRR regulatory requirements, including CRR credit risk modelling requirements, are described above in this Principal Risks and Uncertainties section. The Bank remains exposed to increased regulatory scrutiny, resource drain, damages, fines and costs, adverse publicity, reputational damage and litigation claims as a result of (a) the eventual outcome of remaining investigations into the events which gave rise to the 2013 capital raising (being remaining investigations into former senior management, the role of the Bank's former auditors for the period up to and including the Bank's 2012 Annual Report and Accounts, and the actions of relevant authorities (regulators and government)) in the event that any of these impact on the Bank itself or (b) any future regulatory investigations, enforcement actions and remediation programs. The financial services industry continues to be the focus of significant legislative and regulatory change which has and could continue to impose operational restrictions on the Bank, increase the Bank's costs and/or capital requirements and/or otherwise materially adversely affect its business, operating results, financial condition and prospects. **Money-Laundering Risk** The Bank remains fully committed to supporting international and domestic efforts to combat money laundering and the funding of terrorist and criminal activity, preventing the illicit use of the Bank's products and services and to meeting the Bank's legal and regulatory obligations in full. While a remediation programme is substantially complete, more work is required to be done in this regard. **Competition Law Risk** In addition, the Competition and Markets Authority (the CMA) published its final report on its market investigation into retail banking on 9 August 2016. The financial and other impact of the remedy package on the Bank is still under review and the impact on the wider industry as a whole is still uncertain. However, the remedies announced will require significant change, cost and complexity to be managed in a relatively short timeframe, particularly in the development and implementation of an open Application Programming Interface (API) standard for banking, which could adversely affect the Bank's business, operating results and financial condition.
3.9	**Conduct Risk** Conduct Risk is defined as the risk that the Bank's behaviours, 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 and packaged accounts, is based on the views and requirements of the Regulators and on current and estimated complaint volumes. Any change in the Regulator's current approach or complaint volumes could have a material impact. During 2015, the FCA proposed a time bar on PPI claims (which of itself could be subject to judicial challenge) and a dedicated marketing campaign to consumers as to their right to reclaim PPI. The FCA initially proposed a time bar to June 2019 and a revised approach to redress calculations in relation to undisclosed commission rates will be adopted. The FCA has recently announced that the time bar will become effective from 29 August 2019 and

	Principal Risks – Definition	Why this is important
	Conduct Risk - continued	the Bank has taken this into account in its provisioning. As at 31 December 2016, a provision of £90.4m (December 2015: £87.0m) had been recorded in respect of potential customer redress and costs relating to past sales of PPI. Forecast future complaint volumes are difficult to predict and may increase, remain constant or decline more steadily due to the proposed time bar, FCA communications campaign and the introduction of the new online PPI complaint system which makes it easier for consumers to contact the Bank. The Bank has substantially completed its programme of a structured risk based assessment of products and provisions, of which the primary focus was the discovery and remediation of existing and new conduct and legal issues. The Bank is currently investigating a number of potential conduct issues including mortgage systems configuration. As at 31 December 2016, the Bank has made a provision of approximately £20.1m for conduct issues in relation to miscalculation of monthly mortgage payments resulting from the misconfiguration of mortgage systems. This provision includes the cost of delivering redress to customers. The current overall conduct provision includes provisioning for the currently estimated redress and delivery costs of a number of conduct issues that are not considered material for specific provision. These issues include products or services relating to bank charges, auto-capitalisation issues, student and certain other overdrafts and loan early settlement charges. In addition, the Bank holds a provision of £8.1m for issues incurred but not yet identified (IBNI) for the year ended 31 December 2016. While progress has been made in resolving conduct issues, there is a risk that the Bank's provisions - whether in aggregate, specific or IBNI - are insufficient, or that already identified issues or further issues may require significant further or new provisioning, and/or significant redress and remediation costs. The Bank is also exposed to the risk that changes in regulation and enforcement policy may give rise to further conduct issues emerging. No assurance can be given that further issues will not be identified, or that any such further or already identified issues may not require new or further provision, or that changes in regulation may not give rise to further conduct risks emerging. As well as PPI, the Bank continues to monitor developments in product related areas that attract increased focus from regulators, the courts and the FOS, such as early repayment charges in both commercial and secured lending and variation of certain product terms and conditions. Changes in the approach to any of these issues in the market could adversely affect the Bank. The Bank initiated a redress programme in respect of various breaches of mortgage conduct of business rules and was the subject of a skilled persons review into potential detriment to its mortgage customers arising from poor arrears handling. The Bank has substantially completed the recommendations from this review and has implemented enhanced policies and processes which are designed to deliver improved customer outcomes. The outcome of the final review is not yet finalised but the risk of further enforcement action by the FCA is considered to be largely mitigated. The Bank has largely completed the remediation of historic breaches of the Consumer Credit Act (CCA), including the payment of appropriate redress to customers. While the remainder of the remediation work is undertaken some current loans will require further remedial steps to ensure they remain compliant. If this work is not fully completed or if other breaches of the CCA emerge then there is a risk of non-compliance with the technical requirements of the CCA which can include interest and default charges paid by a customer in prior periods being required to be refunded and the customer agreement not being enforceable by the Bank without a court order until the breach is remedied. In certain circumstances, the Bank may be unable to rectify the historic issues accurately or at all, which may lead to continuing non-compliance with the CCA.
3.10	**Pension Risk** The Bank will take appropriate actions to manage pension risk exposure (deficit recovery contributions and Individual Capital Guidance) in its capital and earnings objectives.	**The Bank is a participating employer in Pace, which has both an active defined contribution section and a closed defined benefit section.** The Pace Scheme is not currently sectionalised and operates on a 'last man standing' basis, with a risk that the Bank's obligation to Pace would therefore increase significantly if another large employer in the scheme (the largest of which is The Co-operative Group) were to become insolvent. The Defined Benefit section of Pace is not further sectionalised. To mitigate this risk, the Bank is now in consultation with The Co-operative Group and the Pace

Principal Risks – Definition	Why this is important
Pension Risk - continued	Scheme Trustee with the aim of separating its liabilities in the scheme from those of other participating employers or exiting the scheme and apportioning its liabilities to other participating employers. At present, there is uncertainty over the Bank's share of Pace liabilities, which the Bank is expecting to resolve as a part of the separation discussion. However, if sufficient information is available to the Bank to identify its share of the underlying financial position and performance of Pace, the Bank will be required to begin defined benefit accounting for Pace which, though the scheme is currently in accounting surplus, would require the recognition of any future accounting deficit on the Bank balance sheet, and recognise in full any future schedule of deficit contributions at the point they are committed to. Uncertain liabilities include the Insurance Liabilities, namely, the liabilities of deferred and pensioner members of the CIS Employees' Pension Scheme which were transferred into Pace on its establishment in 2006. The Insurance Liabilities are 'orphan liabilities' if the Trustee chooses not to exercise its discretion to 'reasonably attribute' the Insurance Liabilities to a particular Pace employer (e.g. The Co-operative Group). The Trustee has confirmed that it has such 'reasonable attribution' discretion under Regulation 6(4) (c)(i)(bb) of The Occupational Pension Schemes (Employer Debt) Regulations 2005. If the Trustee exercised its discretion to reasonably attribute the Insurance Liabilities to The Co-operative Group, in broad terms the Bank's share of Pace might be circa 15% of Pace. If however the Insurance Liabilities are 'orphan liabilities', the Bank may be allocated a pro-rata share of them. The Bank's share of Pace might then be circa 21%. The Pace Trustee has indicated it is currently not minded to exercise its discretion to allocate Insurance Liabilities to Group, and therefore there is a risk the Pace Trustee finally exercises its discretion to confirm that Bank will be allocated a pro rata share. In order to progress pensions separation discussions, the Bank is not currently actively resisting this potential allocation approach and has indicated it would be minded to agree it, subject to stakeholder consent and in the context of achieving separation. In so doing, there is a risk that the Trustee will take the Bank's current approach as encouragement to posit its exercise of discretion as final. There is therefore uncertainty as to the quantum of Pace liabilities for which the Bank will take responsibility. Further, there is uncertainty as to the costs to achieve separation and the funding contributions and/or contingent assets required in a separated scheme. The next triennial valuation of the defined benefit section of Pace will be determined as of 5 April 2016, with the statutory deadline for completion being 5 July 2017. Until this is completed, there is uncertainty as to the funding deficit in the scheme at the valuation date and the consequent deficit that the Bank will contribute towards, over which uncertainty exists irrespective of whether separation is completed. **The Bank is the sponsor of the Britannia Pension Scheme, which is a closed defined benefit scheme.** The scheme's triennial actuarial valuation as at 5 April 2014 has been finalised, and a schedule of contributions has been agreed. The next triennial valuation will be undertaken as of 5 April 2017 and with the current macroeconomic outlook, there is the risk that the scheme's funding position may have deteriorated by such time and the subsequent risk that the Bank may be required to fund an increased level of deficit. Some of the risk posed to the Bank's capital resilience has however been mitigated in H2 2016 as, with the agreement of the Trustee, a number of changes were made to the scheme rules whereby the Bank is now deemed to have a right to a refund over any surplus that might arise at the end of the scheme's natural life assuming gradual settlement of scheme liabilities over time until no beneficiaries remain.. This has the effect that the Bank is not currently required to recognise a liability for any deficit contributions it has committed to. In addition macroeconomic deterioration may negatively impact the IAS 19 surplus/deficit position on the balance sheet and the pension reserve recognised in the Bank's CET1 capital resources, leading to erosion in the Bank's capital resources.

Footnotes to Principal Risks and Uncertainties

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

2. PRA PS 30/16 'The minimum requirements for own funds and eligible liabilities (MREL) buffers and Threshold Conditions' was published on 8 November 2016 and sets out that PRA proposes to adopt a policy that if a firm is in breach of its MREL requirement, it would not automatically mean that the PRA will consider the firm is failing, or likely to fail, to satisfy Threshold Conditions (http://www.bankofengland.co.uk/financialstability/Documents/resolution/mrelpolicy2016.pdf).

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

VIABILITY STATEMENT

In accordance with provision C2.2 of the 2014 UK Corporate Governance Code, the Board is required to assess the prospects of the Bank over a period longer than the 12 months required by the Going Concern Provision, separately set forth on page 154 of this Report.

When considering the viability of the Bank, the Directors have referenced appendix B of the Financial Reporting Council's Guidance on Risk Management, Internal Control and Related Financial and Business Reporting published in September 2014 (the FRC Guidance), which explicitly covers the longer term viability statement.

For a complete understanding of this viability statement, please refer to the Principal Risks and Uncertainties section (the PRU), the Risk Management section for a detailed analysis of how these risks are managed within the Bank's Risk Management Framework, and the Going Concern statement within note 1 of the Financial Statements. All of the risks and uncertainties described therein are considered as qualifications to the Bank's prospects over the period of assessment described below.

Recent announcements
The Bank announced on 26 January 2017 that it expected its CET1 ratio to fall and remain below 10% over the medium term and that it was also unlikely to meet its Individual Capital Guidance (ICG) over the planning period to 2020. The Bank continues to expect to meet its Pillar 1 capital requirements and to maintain sufficient liquidity to meet its obligations.

On 13 February 2017 the Bank announced that it was commencing a full sale process, inviting offers for 100% of its issued share Capital and was also considering other options to build capital and meet the longer term capital requirements applicable to all UK Banks.

Assessment of Bank prospects
The Board approved 2017-2021 Strategic Plan (the Plan) forecasts the Bank's performance over the next five years. However, given the material risks and uncertainties summarised in the PRU section, including the risks and uncertainties with regards to the successful execution of the management actions contained in the Plan, the Directors have concluded that the viability of the Bank would be more appropriately assessed over a three year period. Moreover, a three year period is in line with the market and is consistent with the assessment period used in the Bank's 2015 Annual Report and Accounts.

A robust assessment has taken place considering those risks that would threaten the Bank's forecasted capital position, regulatory compliance, future performance, solvency or liquidity position, including its resilience to the threats to its viability posed by those risks in severe but plausible scenarios.

The primary focus of this assessment is the Plan. The Bank's management considered a number of scenarios during the planning process. The Plan was also subjected to extensive challenge by various internal and external stakeholders including the PRA. After the completion of this process, the Plan was finally proposed to, and approved by, the Bank's Board and accepted by the PRA.

Creation of the Plan involved detailed building of individual business units' strategies, and the associated key assumptions, which were discussed and challenged by the Bank's Risk Framework Owners and assessed by the Bank's internal risk function.

The key assumptions included within the Plan, and on which the Directors have made their assessment, include:

- That the anticipated future interest rate profile remains at historic lows in the short to medium term and will remain below the historic position observed within the UK pre-2008 across the Plan period. However, when the Bank forecasts rates are to rise in the Plan the Bank forecasts an increase in net interest margin and preservation of market share;

- The Bank achieving a successful execution of the sale or Capital Raising outlined in the Bank's market announcement on 13 February 2017 and its franchise remains intact as it works towards that goal;

- That the planned MREL debt can be issued on acceptable terms from 2018 and that there will be considerable improvements in the pricing of issuances in the latter years of the Plan given a forecasted improvement in the Bank's financial and regulatory positions;

- The Bank is able to deliver the remaining transformation and change programmes already underway and the significant cost reduction initiatives in the Plan without material deviation from targeted timescales and outcomes;

- The Bank's various regulators continue to accept the Bank's plan to address non-compliance which currently includes the regulatory requirements which are set out in the PRU section and include non-compliance with ICG, PRA buffer and CRR as outlined in the Plan;

- The Plan assumes the Bank does not become exposed to significant new conduct or legal risk either due to the Bank discovering new significant conduct issues arising from legacy Bank practices or from changes in regulatory approach to previous general market practice that would require increased levels of provisioning; and

- There are no further significant regulatory changes imposed on the Bank including changes that impact capital requirements.

In reviewing the Plan the Board reviewed compliance with key capital and liquidity risk appetites. In doing so, the Board also assessed key performance indicators and the impact of the PRU to the overall performance of the Bank and its ability to continue to operate and meet its liabilities during the Plan period.

Many of the Bank's risks are assessed through sensitivity analysis. This includes, amongst others, modelling the impact of changes to variations in the Bank of England base rate, the impact of one-off cost increases which may arise from overspend in the Bank's change programmes and operating cost base, potential further charges in respect of conduct and legal risks and the potential impact of significant revisions to accounting standards. Moreover, the Bank has assessed the impact on the Bank's financial position and ongoing annual costs if it were to increase its loss absorbing capacity including MREL debt issuances.

The Bank has prepared forecasts based on the economic scenario aligned to the PRA (H1 2016) stress scenario. The stress results in a reduction in the Bank's new business volumes following market contraction, lessens the Bank's ability raise wholesale funding and to deleverage any further Legacy Portfolio assets and increases impairment across the Bank's asset portfolios. The Bank has also prepared a combined stress test which includes a number of appropriate idiosyncratic stress events covering a number of the risks outlined above. Without a capital raise the Bank does not pass any of these stress scenarios, principally because it is not compliant with its ICG before any stresses are applied.

The Plan and the stress testing performed during the planning process will form the basis of the Bank's 2016 ICAAP that will be formally submitted to the regulator along with the outcomes of reverse stress testing for review and challenge in 2017.

Financial performance is tracked as part of the Bank's monthly Board performance reporting. These reports include a view of the forecasted full year financial position compared against the Plan. On a periodic basis this forecast is extended to cover the planning horizon and highlight areas of significant deviation. This process considers the emerging risks and opportunities and includes appropriate sensitivity analysis.

The Plan includes a series of management actions, which seek to build a capital buffer sufficient to absorb the impact of the combined stress scenario modelled by the Bank and meet the PRA buffer by the end of the planning horizon.

Board view of prospects

Given the material risks and uncertainties summarised in the PRU and short term uncertainties involved in the Capital Raising and longer term uncertainties involved in any plan as a result of unanticipated macroeconomic changes, and regulatory trends, amongst other factors, the Directors judge that the maximum appropriate period for forecasting viability of the Bank is three years.

It is noted that the Bank had made progress against the previous Plan accepted by the PRA in March 2016, and that a number of adverse impacts have materialised which result in material deviations to the projections included therein. However, the Plan reflects the Board's belief that within the next three years, the Bank will have made substantial progress towards finishing its transformation programme, the Bank franchise rebuild and elements of further Legacy Portfolio deleverage. The Bank has already seen a small growth in personal account volumes in 2016 and increased the level of mortgage origination when compared to 2015. In addition, the operating costs for the Bank have decreased as a result of the targeted cost reduction initiatives. If the series of management actions included with the Plan, particularly the Capital Raising, are successful then the Bank also anticipates that it will be ICG and CRR compliant within the assessment period.

Key to the Bank's viability is that the Bank's various regulators continue to accept the Bank's plans to address non-compliance with the Bank's regulatory requirements as set out in the PRU section. Such matters include non-compliance with ICG, PRA buffer and CRR. The Bank understands its regulators are particularly focused on closely monitoring management's delivery of the remediation actions which relate to the embedding of its Risk Management Framework, the required actions to improve internal modelling capabilities, remediation of its IT systems and disaster recovery capability and potential MREL debt issuances. The Bank has received confirmation from the FCA that they consider the breach of IT Threshold Conditions has been remediated and the Bank to be compliant with IT Threshold Conditions.

Conclusion

The Plan provides the basis on which the Directors have concluded that they have a reasonable expectation the Bank can continue to operate and meet its liabilities, as they fall due, for the next three years. As described above, there are many risks and uncertainties in the successful delivery of the Plan. The Bank remains dependent on the continued acceptance of the Plan by its regulators given the material risk and uncertainties referred to in the Going Concern statement, the PRU and the above risks, uncertainties, qualifications and assumptions. These material risks and uncertainties are described further in note 1.2 to the financial statements.

SOCIAL, COMMUNITY AND HUMAN RIGHTS

Our Values, Ethics and community impact
The Co-operative Bank is defined by its Values and Ethics, which represent a clear point of difference that sets us apart from our competitors and in 1992 we were the first bank in the UK to launch a customer-led Ethical Policy. Today's policy has evolved through five comprehensive reviews, all of which have been based on consultation with a total of over 320,000 customers and colleagues and all of which have strengthened our ethical credentials. In 2015 the Policy was extended and now includes five key pillars covering every aspect of the Bank's operations. We still hold to our commitment to screen every new non-personal account, and we don't lend customers' money to organisations that go against the Ethical Policy. Now, our commitment also goes much further.

Together the five pillars of our Ethical Policy guide and shape all aspects of our business – from our impact on the environment, the products and services we offer, the relationships we have with suppliers and colleagues, to the campaigns we support and our involvement in local communities. This enables us to stay true to our customers', colleagues' and stakeholders' aspirations to deliver a stand-out ethical banking service.

In 2017, the Bank will be marking 25 years of our Ethical Policy and what it has achieved. With Values and Ethics embedded in the Articles of Association of the Bank, our approach is embedded across the business, and delivery of the Policy is overseen by the Values and Ethics Committee of the Board. Our continuing commitment to co-operative values remains and is also strengthened by the inclusion of a clause in our Articles of Association which requires colleagues to act in line with the values associated with the co-operative movement.

Our colleagues volunteer in their communities
Our employee volunteering programme is a key pillar of our community engagement strategy. We encourage all colleagues to take part in team challenges or volunteer on an individual basis with community organisations and charities. In 2016, 559 colleagues volunteered 4,099 hours to their local communities, carrying out 43 team challenges.

The Bank's volunteer programme benefited people in communities across the UK during 2016. Our colleagues made a difference supporting community organisations, working to upskill the long-term unemployed, supporting children with their literacy and numeracy skills, protecting the environment, and providing vital social care for vulnerable groups.

Our work for vulnerable customers
In 2016 the Bank linked up with Citizens Advice Manchester (CAM) to launch a pioneering referral programme for customers who find themselves in financial difficulty. The Bank has provided funding for a dedicated resource at CAM who will work with particularly vulnerable customers. Uniquely, this resource will support customers in financial difficulty, looking at their overall financial circumstances, and not just the accounts they hold with the Bank.

The impact of our charity partnerships
The Co-operative Bank offers credit cards linked to five affinity charity partners including Amnesty International, Oxfam, Save the Children, Tearfund and The Woodland Trust. They enable customers to make a small donation to their chosen charity, through every transaction. Our Everyday Rewards current account also enables customers to donate their monthly earned rewards to five charity partners including Amnesty International, Hospice UK, Oxfam, Refuge and The Woodland Trust. Together these customer donations raised almost £880,000 for our partner charities in 2016. We were delighted that in the first half of 2016, we reached the milestone where our customers have now donated over £5m to Oxfam over the course of a 20 year relationship between Oxfam and the Bank.

In addition, through the actions of our colleagues and a match funding element from the Bank, we donated over £50,000 to 40 local and national charities through our annual colleague fundraising challenge.

Campaigning for change
With the support of our customers, the Bank has also returned to its campaigning heritage – and in 2016 delivered a campaign to raise awareness of and tackle the issue of financial abuse in intimate relationships, 'My money, my life', was developed in partnership with leading charity Refuge. We are proud of what this campaign has achieved and that it has paved the way for a new industry code of practice on this issue in 2017.

A £1m three year partnership to support co-operatives

Our co-operative roots remain integral to what we do. In January 2015, the Bank committed to support the growth of the co-operatives sector in the UK. We are delivering on this commitment by contributing £1m to a three-year partnership with Co-operatives UK, called 'The Hive'.

Launched formally in 2016, The Hive seeks to support the 6,796 co-operatives already operating in the UK and help others starting up. The Hive provides business advice and guidance as well as peer mentoring and group training sessions on key issues such as registration, membership development and co-operative finance. As at November 2016 The Hive had so far supported 77 groups and delivered £66,000 worth of expert advice to cooperative organisations through its online portal.

'Why is The Hive so important? Through the Bank's support of The Hive, together we are able to support jobs and growth in a vital part of the economy. But you discover its value when you see The Hive's impact on the ground. Cookoo Farm Print Workshop is a valuable community resource in Colchester, offering both training and a workshop base; without The Hive it would no longer exist. It is co-operation in action and there are numerous further examples. New revenue streams have opened up for The Old Print Works in Birmingham, while a young London-based creative team, Blake House Filmmakers Co-operative, described their peer mentoring support as 'absolutely essential' to their development. To these organisations and more, The Hive has been a vital source of support and inspiration – and over the course of 2017 we anticipate the emergence of many more co-operative stories'

Ed Mayo, Secretary General of Co-operatives UK

'It has helped us address areas we haven't yet had chance to… It's allowed us to develop our HR department and get into place the policy and documentation that we need to develop our co-op. It's also helped us in terms of business and client management, marketing and accountancy.'

Simon Ball, Co-Founder of Blake House Film Co-operative.

Environmental protection and greenhouse gas (GHG) reporting

Protecting the environment (including tackling climate change) is one of the key goals of our Ethical Policy and we do not lend to businesses or projects that conflict with our environmental sustainability commitments. In 2016, we declined banking services to three businesses involved in the provision of strategic services to the oil and gas sector which were considered intrinsic to the extraction process.

We also seek to minimise our own environmental impacts. We continued to source the vast majority of our electricity from renewables in 2016, and maintained our 'beyond carbon neutral' status for the eighth consecutive year, offsetting our operational greenhouse gas (GHG) emissions[1] plus an extra 10% to address legacy issues. We do this by supporting carbon reduction projects, identified through climate and development experts ClimateCare.

As well as offsetting our carbon emissions, these projects provide additional benefits for people and the environment. For example, we supported a water filter project in Kenya that not only reduces wood burning, but also improves the health of the communities by providing clean water. The Carbon For Water programme is one of the world's largest clean water interventions, providing more than 3.5 million Kenyans with access to safe water.

We have been reporting our GHG emissions for over 17 years, measured in carbon dioxide equivalent (tCO2e) using the latest UK Government guidance[2]. Our direct GHG footprint encompasses energy consumption, refrigerant leakages from our premises and all business travel (air, rail and road). All greenhouse gas data and related commentary is externally assured[3].

Total GHG emissions by source

	Total emissions (tCO2e)		
Source of emissions	**2016**	**2015**	**2014**
Fuel combustion	2,009	2,449	2,774
Electricity Consumption [4,5]	16,182	20,068	24,335
Refrigerant leakages [6]	185	131	373
Business travel	1,183	995	1,121
Total	19,559	23,643	28,603
Carbon intensity (tCO2e/FTE[7])	4.41	4.19	4.87

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 (DEFRA), 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. DNV GL has provided limited assurance of the GHG data and commentary as part of the Bank's Values and Ethics 2016 Report assurance. In that report the assurance statement sets out the scope of work and standards used to form their opinion.
4. If electricity from renewable sources is accounted as zero carbon then emissions from electricity would be 162 tCO2e.
5. GHG emissions are calculated using the most up to date conversion factors published by DEFRA.
6. Refrigerant gas data includes major occupancy properties only.
7. Average number of full time equivalent (FTE) employees for the year.

Corporate Governance

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BIOGRAPHIES OF THE BOARD

1. 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 45 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.

2. Aidan Birkett - Senior Independent Director

Aidan joined the Board in July 2015. He built his career within the professional services sector over more than 30 years with PwC and Deloitte. He was head of Deloitte's Corporate Finance business and a member of the firm's executive committee. He has led a number of high profile strategic and commercial reviews of businesses in varying turnaround situations, in the UK and overseas. This has provided him with significant experience in the wholesale finance sector and an understanding of the retail customer segment across a number of non-financial sectors. Aidan has served as a consultant, director and advisor in various capacities and has held various Non-Executive Director roles. He is currently a Non-Executive Director with the Dubai Group.
Committee membership: Audit, Nomination, Remuneration.

3. Derek Weir - Non-Executive Director

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

4. Glyn Smith – Non Executive Director

Glyn joined the Board on 10 October 2016, becoming Chairman of the Audit Committee on 26 October 2016. Glyn has over 35 years of experience in the financial services sector, most notably in a number of senior executive roles in Barclays Bank and as Group Finance Director of the Portman Building Society. Since 2003, he has held numerous non-executive directorships and chaired the audit committees of organisations across both the public and private sectors. These have included Coventry Building Society, Domestic and General Group and Stroud & Swindon Building Society in the financial services sector. Glyn is a graduate of Cambridge University and a Chartered Accountant. He is a former member of the examinations team of the Institute of Chartered Accountants in England and Wales. He is currently a Non-Executive Director and Chairman of the Audit and Risk Committees of FCO Services and The Reclaim Fund Ltd.
Committee membership: Audit (Chairman), Risk.

5. Laura Carstensen - Non-Executive Director

Laura was appointed to the Board in May 2014. Laura is a former partner at the City law firm, Slaughter and May. Laura is a former Member and Deputy Chair of The Competition Commission (now The Competition and Markets Authority). She is currently a Non-Executive Director and Chair of Park Group plc. She is an advisory group member of Vote 100 and a Non-Executive Director of NHS Improvement.
Committee membership: Values and Ethics (Chair), Risk, Remuneration.

6. 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 in the financial and public sectors, including the British Council, NYSE EURONEXT, LIFFE, Barclays, Standard Chartered Bank, EBRD and Reuters. Maureen holds professional qualifications from the Chartered Institute of Personnel and Development and was appointed a Fellow of the CIPD in 1992. She is also a Pensions Management Institute qualified Trustee. From 2010 until 2015 Maureen was a Non- Executive Director, Independent Governor and Trustee of London Metropolitan University and is currently a Non-Executive Director and Trustee of Reuters Pension Fund.
Committee membership: Remuneration (Chair), Nomination, Values and Ethics.

7. 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 a member of the Council, and President of the Alumni Association at Cranfield University School of Management and is on the management and Board of Leeds University Business School. Bill serves as the Chair of the Royal Navy and Royal Marines Charity. Additionally, he is a Director on the Advisory Board of Fire Eye Inc., a Non-Executive Director of Spirent Communications plc, and a partner in Hopton Estates.
Committee membership: Audit, Risk, Values and Ethics.

8. Charles Bralver - Non-Executive Director

Charles joined the Board in April 2015. Charles was a founding partner of Oliver Wyman & Company where, from 1984 through to 2007, he held several positions, including Vice Chairman, Head of Europe, Head of North America, and Head of the Global Capital Markets Practice. He has over 30 years' financial services experience, including two years as a Strategic Advisor on Financial Services at Warburg Pincus LLC. He is the former Senior Associate Dean for International Business and Finance at the Fletcher School of Law and Diplomacy at Tufts University in Boston, USA. He is currently a member of Oliver Wyman's Senior Advisory Board and a Non-Executive Director of Canaccord Genuity Group Inc. and NewStar Financial Inc. and a member of the Investment Committee at Ultra Capital Partners. He also acts as a Senior Advisor on Financial Services to Silverpoint Capital, and is a member of Chatham House, London.
Committee membership: Risk.

9. Alistair Asher – Non Executive Director

Alistair joined the Board in September 2016. Alistair is a Solicitor and was appointed as General Counsel of The Co-operative Group in July 2013. Prior to this Alistair was a Partner at Allen & Overy LLP and was Global Head of the Financial Institutions Group. Alistair is currently a Non-Executive Director and Chair of Co-operative Legal Services Limited and Non-Executive Director of its subsidiary The Co-operative Trust Corporation Limited. He is also a Non-Executive Director of CIS General Insurance Limited; the Federal Retail & Trading Services Limited; and NOMA (GP) Limited.
Committee membership: Values and Ethics.

10. Liam Coleman – Chief Executive Officer

Liam joined the Board in July 2016. Liam was appointed as Deputy Chief Executive Officer on 3 May 2016 having joined The Co-operative Bank plc in June 2013 as the Treasurer and subsequently Director of the Retail & Commercial Bank on 1 September 2014. Liam has 25 years' experience in the industry and prior to joining the Bank Liam was Deputy Group Treasurer and Group Head of Capital Management at RBS from February 2011 to June 2013 and he worked at Nationwide Building Society from 1996 to 2011, ultimately as Group Director, Treasury where he had responsibility for all the treasury activities of the society. Earlier in his career, Liam worked at NatWest in corporate banking and at Hambros and Bank of Tokyo-Mitsubishi in corporate and structured finance. Liam is a former Non-Executive Director of Great Western Hospitals NHS Foundation Trust. On 1 January 2017, Liam became Chief Executive Officer of the Bank, replacing Niall Booker.
Committee membership: Values and Ethics.

11. John Worth – Chief Financial Officer

John joined the Bank on 1 September 2016 and became Chief Financial Officer on 11 October 2016. He has over 30 years' experience in the financial services industry in Finance, IT and Risk Management roles. He most recently worked as the Chief Financial Officer of two publicly listed insurers, Hiscox and Aspen Insurance Holdings. Prior to that, he was Group Financial Controller at Barclays and has also held senior roles at Ernst & Young LLP, Prudential and Price Waterhouse, where he worked for the London, Tokyo and Grand Cayman offices. Since 2002 John has worked extensively in a fundraising and a finance-advisory capacity for the NSPCC. He is a Trustee Director and Honorary Treasurer of the NSPCC and a member of the NSPCC Great British Chefs Dinner Committee.

DIRECTORS' REPORT

The Directors present their report and audited accounts for the year ended 31 December 2016.

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 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 as it does not meet the combined buffer requirement and accordingly does not recommend payment of a dividend.

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 6. Financial risk management objectives and policies can be found as detailed below:

	Pages
Detailed Financial Review	14
Detailed Key Performance Indicators	32
Principal Risks and Uncertainties	35
Risk Management objectives and policies	102
Events after the Balance Sheet date	220, 251

Going Concern
There continues to be material uncertainty around the execution of the Bank's 2017-2021 Strategic Plan, and its ability to continue as a going concern. These are included in the Principal Risks and Uncertainties section and Going Concern disclosure in note 1 to the Bank financial statements.

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 page 6. 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.

Consequently, after due analysis, the Directors have concluded that the risks highlighted within the Principal Risks and Uncertainties coupled with those set out in detail in the Basis of preparation in note 1 to the Bank financial statements section of the Annual Report and Accounts, represent material uncertainty which may cast doubt upon the Bank's ability to continue as a Going Concern. When making this assessment, the Directors act within the principles of the Financial Reporting Council's 'Guidance on the Going Concern Basis of Accounting and Reporting on Solvency and Liquidity Risks 2016' report.

Nevertheless, after making enquiries of management and considering the Plan, in particular for the 12 month period following the date of approval of the Bank's financial statements, 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.

Therefore this set of financial statements does not include the adjustments that would result if the Bank was unable to continue as a Going Concern.

The Directors have considered the ongoing viability of the Bank; this can be found in the Viability Statement.

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 61 of the Governance section of the report.

Details of the Directors offering themselves for election and re-election at the 2017 Annual General Meeting are provided on page 62.

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.

Significant contracts
Details of related party transactions are set out in note 36 to the Bank financial statements and note 25 to the Company financial statements.

Corporate responsibility
The Bank's corporate responsibility activities are outlined on page 51.

CO_2 emissions
The Bank's greenhouse gas emissions report is detailed on page 52.

Employees
The Bank has committed significant investment to implement a cultural transformation programme, led by the Chief Executive Officer and Executive Team, which will embed new workplace values throughout the organisation. The roll out of this began in the second half of 2014 and continued during 2015 and 2016.

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. A revised Performance Management Policy was 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. The Bank runs a successful graduate scheme with over 30 graduates now in the scheme.

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 2016, 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.

In January 2015, as part of its new Ethical Policy, the Bank committed to paying colleagues no less than the living wage. It re-affirmed this commitment in 2016.

Employees with disabilities
During 2016, the Bank continued to be a Disability Confident employer (level 2) with commitment to recruit and retain disabled people and people with health conditions for their skills and talent. The Bank has policies and processes in place to support disabled colleagues in the workplace and recognises its responsibility for making reasonable adjustments for new colleagues and for those individuals who develop disabilities whilst in employment. Further guidance and information for colleagues on disability issues is available through Human Resources and on the colleague intranet.

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 page 59 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).

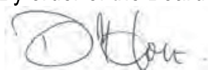
Each of the persons who is a Director at the date of approval of this annual report confirms that:

- so far as the Director is aware, there is no relevant audit information of which the Bank and Company’s auditor is unaware; and
- the Director has taken all the steps that he/she ought to have taken as a Director in order to make himself/herself aware of any relevant audit information and to establish that the Bank and Company’s auditor is aware of that information.

The confirmation is given and should be interpreted in accordance with the provisions of S418 of the Companies Act 2006.

Ernst & Young LLP have expressed their willingness to continue in office as auditor and a resolution to reappoint them will be proposed at the forthcoming Annual General Meeting.

By order of the Board



Dennis Holt
Chairman
08 March 2017

CORPORATE GOVERNANCE REPORT

Chairman's introduction

The Board has witnessed significant changes during 2016; however, I believe that despite the various changes we have an appropriate balance of knowledge, skills and independence capable of meeting the challenges facing the Bank. Establishing 'Tone at The Top' is vital for the whole business and the appointment of a new Chief Executive Officer to take over from Niall Booker with effect from 1 January 2017 was a vital consideration for the Board. In May 2016 Liam Coleman was appointed to a newly created position of Deputy Chief Executive Officer in contemplation of him succeeding Niall Booker at the year end when Niall`s fixed term contract expired. It was essential to create a smooth and seamless transition and I know that Liam will prove to be a strong and effective leader of the business.

During the year we also saw the departure of John Baines as Chief Financial Officer and we welcomed John Worth as his successor on 11 October 2016.

There was also change in the make-up of our Non-Executive Directors with Graeme Hardie and Richard Coates stepping down from the Board during the year. In October 2016 we welcomed Glyn Smith onto the Board as an Independent Non-Executive Director along with Alistair Asher who was nominated by The Co-operative Group as a Non Independent Non-Executive Director under the terms of the Relationship Agreement and joined the Board in September 2016.

At the 2017 AGM, all the Directors will stand for election or re-election.

As we expected, 2016 saw further 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.

Finally, on behalf of the Board, I would like to thank our outgoing Executive and Non-Executive Directors for their work and contribution during their respective terms. I am confident that we have an excellent team ready to address the many challenges of the year ahead.

Dennis Holt
Chairman
08 March 2017

Compliance with the UK Corporate Governance Code
The UK Corporate Governance Code, published by the Financial Reporting Council in 2014 (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 Board considers that the Company complied with the provisions of the Code for the year ended 31 December 2016: a copy of the Code is available at www.frc.org.uk

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 principal 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). Both the Matters Reserved for the Board and the CEO's delegated authorities have been revisited by the Board and re-adopted for 2017 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 Matters Reserved for the Board can be viewed on the Bank's website at:
www.co-operativebank.co.uk/aboutus/governance/matters-reserved-for-the-board

The Board
As reported in the Chairman's introduction to this report, there have been changes to the Board during 2016.

Composition
Details of the members of the Board, their biographies and details of length of service are set out on page 54.

During 2016, the following Directors were appointed: Liam Coleman on 11 July 2016, Alistair Asher on 12 September 2016, Glyn Smith on 10 October 2016 and John Worth on 11 October 2016. At the end of 2016, the Bank's Board of Directors comprised three Executive Directors (Niall Booker, John Worth and Liam Coleman) and nine Independent and Non-Independent Non-Executive Directors (including the Chairman). Niall Booker's term of office as a Director came to an end on 31 December 2016, returning the number of Executive Directors on the Board to two as at 1 January 2017.

Graeme Hardie stepped down from the Board at the AGM following expiry of his three year term. Richard Coates completed his three year term and stepped down following the appointment of Glyn Smith as his successor as Chairman of the Audit Committee.

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 Bank regards William Thomas, Laura Carstensen, Maureen Laurie, Derek Weir, Aidan Birkett and Glyn Smith as Independent Non-Executive Directors. Dennis Holt has been regarded as an Independent Non-Executive Director, within the meaning of 'independent' as defined by the Code and on his appointment as Chairman on 27 October 2014. Neither Charles Bralver nor Alistair Asher are considered independent for the purposes of the Code.

All the Non-Executive Directors have considerable experience and make valuable contributions to the Bank. The 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 Non-Executive Directors are of sufficient calibre and number such that their views carry significant weight in the Board's decision making.

Board Changes
During 2016 four Directors were appointed to the Board and four Directors stood down.

Current members of the Board		Independent	Appointed
Dennis Holt	Chairman	On appointment	3 February 2014
Aidan Birkett	Senior Independent Director	Independent	1 July 2015
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
Charles Bralver	Non-Executive Director	Not Independent	23 April 2015
Alistair Asher	Non-Executive Director	Not Independent	12 September 2016
Glyn Smith	Non-Executive Director	Independent	10 October 2016
Liam Coleman	Chief Executive Officer	N/A	11 July 2016
John Worth	Chief Financial Officer	N/A	11 October 2016

Members of the Board stepping down since 1 January 2016		Independent	Appointed	Ceased to be a Director
Niall Booker	Chief Executive Officer	N/A	11 June 2013	31 December 2016
John Baines	Chief Financial Officer	N/A	1 October 2014	11 October 2016
Richard Coates	Non-Executive Director	Independent	16 January 2013	26 October 2016
Graeme Hardie	Non-Executive Director	Independent	1 May 2013	21 June 2016

Nominee Directors
For so long as The Co-operative Group Limited remains a bona fide co-operative society, it 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 Co-operative Group took up the option to appoint a Director to the board, Alistair Asher, on 12 September 2016. This appointment is not regarded as independent for the purposes of the Code.

Under the May 2014 Capital Raising, two of the Company's largest shareholders (Silver Point Capital and Perry Capital) were granted the right to nominate a Non-Executive Director. Silver Point nominated Charles Bralver. Perry Capital has not yet nominated a Non-Executive Director. Details of the key terms of the Relationship Agreement and the Shareholder Rights Agreement can be found on page 65.

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 and constructive relations between the Executive and Non-Executive Directors, to ensure Directors receive accurate, timely and clear information and to ensure 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 in January 2017.

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. Niall Booker was CEO until the expiry of his fixed term contract on 31 December 2016. Liam Coleman took up the role of CEO on 1 January 2017.

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 Worth is the Chief Financial Officer and a member of the Board.

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 for the Board.

The current Secretary is Brona McKeown who is also General Counsel of the Bank.

Appointment and Reappointment 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 2017. 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 54 to 55 and can also be found on our website at: www.co-operativebank.co.uk/aboutus/governance/Directors

How the Board operates

Meetings and attendance
The Board usually meets on a monthly basis and additionally as required. In 2016 there were 13 business as usual scheduled meetings (including two scheduled strategy meetings) and two additional meetings to consider strategy. The Chairman and Board members also receive updates from the CEO and members of the Executive team between meetings.

During 2016, 17 additional ad hoc 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.

The Board is scheduled to hold nine Board meetings and one strategy meeting in 2017. The strategy meeting 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 seven days before a meeting.

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

Name	Date of Appointment	Date ceased to be a Director	Board Meetings attended[1] (entitled to attend)[2]	Audit Committee attended[1] (entitled to attend)[2]	Risk Committee attended[1] (entitled to attend)[2]	Value 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	03/02/2014		13 (13)			4 (4)	13 (14)	4 (4)
Richard Coates	16/01/2013	26/10/2016	10 (11)	11 (12)	8 (8)			
Graeme Hardie	01/05/2013	21/06/2016	5 (5)	7 (7)	3 (4)		6 (8)	
William Thomas	28/10/2013		13 (13)	4 (4)	9 (9)	4 (4)		2 (2)
Laura Carstensen	27/05/2014		13 (13)		4 (4)	4 (4)	14 (14)	
Maureen Laurie	30/06/2014		13 (13)			4 (4)	14 (14)	4 (4)
Derek Weir	25/07/2014		13 (13)	13 (13)	9 (9)			
Niall Booker	11/06/2013	31/12/2016	13 (13)					
John Baines	01/10/2014	11/10/2016	10 (10)			3 (3)		
Charles Bralver	23/04/2015		13 (13)		8 (9)			
Aidan Birkett	01/07/2015		13 (13)	13 (13)			6 (6)	4 (4)
Alistair Asher	12/09/2016		4 (4)			1 (1)		
Liam Coleman	11/07/2016		3 (3)					
Glyn Smith	10/10/2016		3 (3)	1 (1)	2 (2)			
John Worth	11/10/2016		3 (3)					

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

Number of meetings in 2016

Board meetings (scheduled):	13
Audit Committee meetings:	13
Risk Committee meetings:	9
Remuneration Committee meetings:	14
Values and Ethics Committee meetings:	4
Nomination Committee meetings:	4

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 2016, all Directors exceeded the time commitment set out in their letter of appointment.

Relations with Shareholders
As at 23 February 2017, 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	% Holding of Ordinary Shares
The Co-operative Banking Group Limited	20.16
SP COOP INVESTMENTS LTD[1]	14.13
Golden Tree Asset Management[2]	12.88

1. SP COOP INVESTMENTS LTD is the entity through which Silver Point Capital holds its investment in the Bank.
2. Golden Tree Asset Management manages its investment in the Bank through various Golden Tree funds.

The Annual General Meeting
The 2016 Annual General Meeting was held at 9 am on 21 June 2016 at 10 Upper Bank Street, Canary Wharf, London, E14 5JJ.
In support of best practice, all resolutions at the 2016 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.

The results of the 2016 AGM can be found at: http://www.co-operativebank.co.uk/assets/pdf/bank/investorrelations/Results-of-2016-AGM-RNS-v1.pdf

Shareholder Engagement
During 2016, the Chairman and the Executive team, led by the Chief Executive Officer and Chief Financial Officer (with the assistance of its Investor Relations team), enabled and continued the dialogue with shareholders, which was reported back to the Board. All Directors are expected to attend the Bank's AGM.

Values and Ethics
Under the Bank's Articles of Association, there is a requirement on the Bank to promote and conduct its business to the extent practicable in a manner informed by the established values of the co-operative movement, in particular with regard to:

- how it relates to, communicates with, balances the interests of, and otherwise deals with its stakeholders; and
- how it applies the profits of the Bank, in accordance with the dividend policy set out in its Articles of Association.

Agreements with Shareholders
In anticipation of the completion of the Bank's LME in December 2013, whereby the Bank ceased to be a wholly-owned subsidiary of The Co-operative Group, and at the time of the Bank's Placing and Open Offer in May 2014, the Bank entered into certain agreements with its shareholders governing matters such as Director appointment rights, conduct of transactions and other governance related matters. These agreements are:

- a Relationship Agreement entered into between the Bank, The Co-operative Group and The Co-operative Banking Group on 4 November 2013;

- a Shareholder Rights Agreement entered into between Silver Point, Perry Capital, Invesco Asset Management Limited and York Capital (collectively, the Committed Shareholders), the Bank, The Co-operative Group and The Co-operative Banking Group on 9 May 2014; and

- a Variation and Director Appointment Deed entered into between the Bank, The Co-operative Group and The Co-operative Banking Group on 10 May 2014.

The following is an overview of the main terms of these agreements.

Director Appointment Rights
Under the Relationship Agreement, for so long as it remains a bona fide co-operative society, The Co-operative Group may appoint and remove:

- up to two Directors for so long as it directly or indirectly controls 25% or more of the rights to vote at a general meeting of the Bank; or
- one Director for so long as it directly or indirectly controls 20% or more (but less than 25%) of the rights to vote at a general meeting of the Bank.

The Co-operative Group's rights were supplemented in the Variation and Director Appointment Deed to the effect that, for so long as it remains a bona fide co-operative society, it may appoint and remove one Director for so long as it directly or indirectly controls 15% or more (but less than 20%) of the rights to vote at a general meeting of the Bank.

With its current shareholding, therefore, The Co-operative Group currently has the right to appoint one Director to the Board. The Co-operative Group took up the option to appoint a director to the board, Alistair Asher, on 12 September 2016.

These agreements also provide that The Co-operative Group's Directors shall not be entitled to vote where there is a potential conflict of interest between the Bank and its group (on the one hand) and The Co-operative Group and its group (on the other). The Co-operative Group has the right to appoint its nominee Director to the Values and Ethics Committee. Following his appointment to the board, Alistair Asher became a member of the Values and Ethics Committee.

The Relationship Agreement also provided a mechanism, varied by an amendment contemplated by the Shareholder Rights Agreement, for the appointment of up to two persons as Non-Executive Directors who were nominated by certain former bondholders who were the purchasers of additional ordinary shares during the LME. Any Directors so nominated must satisfy the criteria to be independent pursuant to the Code. Two Directors, Derek Weir in 2014 and Aidan Birkett in 2015 were appointed pursuant to these rights.

Finally, under the Shareholder Rights Agreement, the Bank has granted to each of Silver Point and Perry Capital (two of its largest shareholders) the right to nominate a Director for appointment to the Board. These rights continue for so long as Silver Point and Perry Capital, as the case may be, directly or indirectly controls 5% or more of the rights to vote at a general meeting of the Bank. Such rights are not transferable, save that they will automatically transfer and be exercisable by another Committed Shareholder if Silver Point or Perry Capital ceases to control such level of voting rights in the Company, provided that such other Committed Shareholder itself directly or indirectly controls 5% or more of such voting rights. Any such Directors so nominated may be, but are not required to be, independent pursuant to the Code. All such Directors are subject to regulatory approval and approval by the Bank's Nomination Committee (such approval not to be unreasonably withheld). Currently, one Director, Charles Bralver (who was nominated by Silver Point), has been appointed pursuant to these rights.

The Relationship Agreement
The Relationship Agreement's other key terms as they affect the Bank's governance are as follows:

- The Co-operative Group is to 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 Bank and The Co-operative Group require the approval of a majority of the Bank's Independent Directors;

- The Bank is required to have a Values and Ethics Committee and the Agreement stipulates its role, which has been reflected in the Bank's Articles of Association; and

- Until 20 December 2016, the Bank could not issue or grant any right to subscribe for any shares or other equity linked securities without the consent of The Co-operative Group.

The Relationship Agreement will continue in effect for so long as The Co-operative Group directly or indirectly controls 20% or more of the rights to vote at a general meeting of the Bank. Certain key obligations of The Co-operative Group will survive any such termination, including its obligations to use the Bank and not to compete with the Bank (described further below).

Shareholder Rights Agreement
The Shareholder Rights Agreement's other key terms as they affect the Bank's governance are as follows:

- If any Director appointed under the Shareholder Rights Agreement is independent, such Director may serve on the Board's Audit and Remuneration Committees, so that at all times at least one such independent Director shall serve on such Committees. If no such Director is independent, at least one of the Directors appointed under the Relationship Agreement by the purchasers of additional ordinary shares during the LME, but only if they are independent, shall serve on the Board's Audit and Remuneration Committees. All such Directors may only serve on the Audit Committee if the Committee considers, acting reasonably, that they are financially literate. As no Director appointed under the Shareholder Rights Agreement is independent, Aidan Birkett is a member of the Audit and Remuneration Committees and fulfils this requirement.

- Subject to a majority of the members being independent, at least one Director appointed under the Shareholder Rights Agreement will serve on each of the Board's Risk and Nomination Committees.

- The Bank agreed to establish, and has established, 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 regard to the timing of such a listing (the Initial Public Offering Committee (IPO Committee)). That sub-committee is 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, have the right to require the Bank to assist in a secondary offering of their ordinary shares, provided that such shareholders intend to sell shares with a value of at least £100 million. The Committed Shareholders may only exercise this right once in any 12 month period and three times in total. 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 selling shareholders and will be paid out of the offering proceeds.

The rights of each Committed Shareholder and of The Co-operative Group under the Shareholder Rights Agreement shall continue for so long as each directly or indirectly controls 5% or more of the rights to vote at a general meeting of the Bank.

Separation from The Co-operative Group

Support Arrangements
In addition to dealing with governance matters, the Relationship Agreement includes certain obligations on The Co-operative Group to use the Bank's services, to promote the Bank's business and support the enhancement and rejuvenation of The Co-operative brand and franchise. Such obligations will continue until the later of two years after the termination of the Relationship Agreement or 20 December 2020.

Non-Compete Arrangements
The Relationship Agreement also includes certain non-compete obligations on The Co-operative Group 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). These obligations will now continue until three years after the termination of the Relationship Agreement.

Branding Arrangements
The Bank owns the trademark rights to The Co-operative Bank. The Co-existence Principles agreed with The Co-operative Group govern the use of trademarks containing 'Co-operative' or 'Co-op' and other associated trademarks owned by both parties. The principles are as follows:

- unless the Values and Ethics provisions entrenched in the Bank's Articles of Association are removed (a Trigger Event), The Co-operative Group cannot conduct any business under a brand that combines the words 'Co-operative' or 'Co-op' and 'Bank';

- 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; and

- after the expiry of the non-compete period in the Relationship Agreement (which is three years after it terminates), The Co-operative Group is free to conduct any financial services business under any of its brands. This is subject to the restriction placed on its use of 'Co-operative' or 'Co-op' with 'Bank', and provided that until five years after the end of the non-compete period, The Co-operative Group may not conduct any business which competes with the Bank under a main business brand including the words 'Co-operative' or 'Co-op'.

Separation Principles
Prior to the LME, certain functions of the Bank were centralised and carried out by The Co-operative Group. Since the LME (whereby the Bank ceased to be a wholly-owned subsidiary of The Co-operative Group), the Bank and The Co-operative Group have been working towards renegotiation of these arrangements. 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, agreements that:

- The Co-operative Group will continue to provide services to the Bank under the same terms that such services are currently provided until alternative arrangements are agreed;
- the Bank and The Co-operative Group will take reasonable steps to avoid the Bank incurring incremental costs and to mitigate costs incurred by both parties from the separation;
- there will be a limit on the mark-up charged by The Co-operative Group for certain 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.

For further information on the separation of the Bank and The Co-operative Group, refer to note 2 of the Bank financial statements.

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's Articles of Association can be found on our website at: www.co-operativebank.co.uk/aboutus/governance/articles-of-association

Board Committees
The Board has established Board Committees, namely, the Audit Committee, the Risk Committee, the Values and Ethics Committee, the Nomination Committee, the Remuneration Committee and the IPO 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 Audit Committee, Risk Committee, Values and Ethics Committee, Nomination Committee and Remuneration Committee can be found at:
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:

	Page
Audit Committee	68
Risk Committee	76
Nomination Committee	79
Values and Ethics Committee	81
Remuneration Committee	88

Governance Structure
The diagram below illustrates the Bank's Board and Management Committee structure as at the end of 2016. The Bank continues to review and refine this structure.

Board Committee		**Executive committee**		
The Co-operative Bank plc Board	Remuneration Committee	CEO	Executive Committee (ExCo)	Transformation Committee (TC)
				Executive People Committee (EPC)
	Audit Committee			Asset and Liability Committee (ALCO)
				Enterprise Risk Oversight Committee (EROC)
	Risk Committee			Technology Steering Committee (TSC)
	Nomination Committee			Model & Rating Systems Oversight Committee (MRSOC)
	Values & Ethics Committee			

AUDIT COMMITTEE REPORT

Introduction by Audit Committee Chairman
'The Audit Committee has continued to provide ongoing oversight and informed challenge over the systems of financial reporting and control, accounts preparation and internal and external audit processes. Through the work of Internal Audit it has provided oversight of the ongoing roll-out of the Risk Management Framework. It also oversees the Bank's Concern at Work (Whistleblowing) arrangements. Ongoing focus on these areas will continue in 2017.'

Glyn Smith
Audit Committee Chairman
08 March 2017

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
Glyn Smith (Chairman)	Appointed 10 October 2016 Chairman since 26 October 2016	
Richard Coates	Appointed 16 January 2013 Chairman since 9 April 2013	26 October 2016
Graeme Hardie	Appointed 30 August 2013	21 June 2016
Derek Weir	Appointed 9 December 2014	
Aidan Birkett	Appointed 23 September 2015	
William Thomas	Appointed 1 July 2016	

During the year Glyn Smith took over the Chairmanship of the Committee from Richard Coates who stood down in October 2016. Meetings of the Committee are generally attended by the Chief Financial Officer, Chairman of the Board, Chief Executive Officer, invited members of the finance and risk teams and the Director of Internal Audit, none of whom attends as of right. The external auditor attends Committee meetings and private meetings are held with internal and external auditors and with the risk function as necessary to afford them the opportunity of discussions without the presence of management. The Committee met 13 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 the external auditor at their meetings.

Principal responsibilities and key areas of discussion

Principal responsibilities of the Audit Committee	Key areas discussed and reviewed by the Committee in 2016
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;
  • the assumptions or qualifications in support of the Going Concern statement and the Viability Statement; and
  • the clarity and completeness of disclosure in the Bank's financial reports and the context in which statements are made.
	• The Committee allocates a number of meetings in its calendar to focus on the preparation for and review of the Interim Accounts and the Annual Report and Accounts. During 2016 the review process included a detailed review of significant accounting judgements and accounting policies and regular dialogue with Ernst & Young LLP. The Accounting Policy Forum reviews all accounting policies for significant transactions and the Key Judgements Forum reviews, challenges and approves all key judgements and associated journal postings. The Committee received regular updates relating to decisions made at the Key Judgements Forum. The Committee also considers the Annual Report and Accounts and Interim Accounts process to assess the impact on Financial Reporting Risk.
	• Key judgements discussed as part of the 2016 accounts process are detailed on page 71, including reports by the external auditor throughout the year.
	• The Board receives a report from the Audit Committee prior to the Board which considers the content of Interim or Annual Reports. Compliance with accounting standards and the completeness of disclosures are also discussed.
	• During 2016 the Committee considered the effectiveness, resource requirements and retention of staff in the finance team.

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 2016, 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 throughout the year. • During 2016, the Committee considered the report on Risk Management, Internal Control and related Financial and Business Reporting in relation to the Bank's Risk Management Framework for the 2015 Annual Report and Accounts. The Committee has reviewed similar disclosure for the 2016 Annual Report and Accounts.

Principal responsibilities of the Audit Committee	Key areas discussed and reviewed by the Committee in 2016
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 Chairman of the Board and to the Chairman of the Committee, 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.	• Between January and March 2016, an independent review of the effectiveness of Internal Audit at the Bank was conducted by Independent Audit Limited, which specialises in reviewing the effectiveness of Boards, Committees and Directors. Their report was presented to the Committee in April 2016 and noted that Internal Audit provided a good source of assurance for the Audit Committee. The report recommended that greater focus was given to succession plans for the Director of Internal Audit. The report recommended a number of areas for improvement, which are in the process of being implemented, but it did not identify any material shortcomings. • During 2016 the Committee reviewed and challenged the Internal Audit Charter, the resources of the function and the plan of activities taking place during the year. • The Committee considers internal audit activity reports covering key Thematic Risks. • The Committee receives all 'red' rated internal audit reports and invites management to present findings and remedial actions. • During the year, in camera sessions were held with the Director of Internal Audit.
External audit • Consider and make recommendations to the Board, to be put to shareholders for approval at the AGM, in relation to the appointment, re-appointment and removal of the external auditor. • Ensure that at least once every ten years the audit services contract is put out to tender and oversee the selection process. • If an auditor resigns, investigate the issues leading to this and decide whether any action is required. • Oversee the relationship with the external auditors and review the findings of the audit with the external auditor. • Approve their remuneration including fees for both audit and non-audit services. • Annually assess their independence and objectivity. • Review any representation letter(s) requested by the external auditor before they are signed by management. • Review the management letter and management's response to the auditor's major findings and recommendations. • Meet regularly with the external auditor and at least once a year, without the presence of management.	• The Committee liaised closely with the external auditor in respect of their views on the most significant of the key accounting judgements and findings. • The Committee reviewed the external audit plan. • In the course of making a recommendation to the Board in respect of representations to the auditor, the Committee reviewed and challenged management assurances supporting management representation letters to the external auditors. • The Committee considered the external auditor's management letter containing observations arising from the annual and interim audits leading to recommendations for control or financial reporting improvement and monitored progress. • The Committee reviewed the services provided by Ernst & Young LLP for audit and non-audit services during the year, and considered the policy for non-audit services in February 2017. • The Committee reviewed the independence of the external auditors and the objectivity of the audit engagement partner and audit staff.
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 Concern at Work (Whistleblowing) Control Standard to the Board. • Annually review the Concern at Work events raised. • Review the adequacy and effectiveness of the Bank's systems and procedures for the prevention of bribery and recommend the Bank's Anti-Bribery & Corruption Control Standard 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 Committee's Terms of Reference and monitor its execution.	• The Committee reviewed reported whistleblowing incidents and the Bank's Concern at Work (Whistleblowing) and Anti-Bribery & Corruption Control Standards. In November 2016 a revised Raising a Concern at Work (Whistleblowing) policy, was created to comply with new regulatory rules, which was recommended to, and approved by, the Board • The Committee considered reporting from the Money Laundering Reporting Officer during the year, including the Annual Money Laundering Reporting Officer's Report. • The Committee conducted an annual review of its Terms of Reference and reviewed its deliveries against these.

Significant accounting matters

In relation to the Bank's 2016 financial statements and half year results the Committee considered the following significant accounting issues, matters and judgements and the disclosure and presentation of these matters were discussed and debated with management and the external auditors (Ernst & Young LLP).

1 Accounting matters considered by the Committee included

1.1 Going Concern and Viability Statement
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 2017-2021 Strategic Plan.

The assessment of the Bank's 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.

The Committee considered and recommended to the Board that Going Concern disclosures prepared by management form part of note 1 to the Bank financial statements.

The Committee also considered the Viability Statement, a requirement under the UK Corporate Governance Code. The Committee considered the period of assessment and discussed factors used in determining if the Bank and Company will be able to continue in operation and meet liabilities as they fall due over the period of assessment.

1.2 Impairment of loans and advances to customers
The Committee reviewed detailed papers prepared by management covering the drivers for changes to impairment provisions which include, as in previous years, the emergence period and probability of default, governance and controls over the provisions and substantive evidence supporting model parameters and appropriate post model adjustments. 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 date.

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

1.4 Outsourcing of mortgage processing services
The Committee considered papers prepared by management which outlined the rationale for the impairment of mortgage outsourcing assets which are no longer expected to be brought into use. The Committee reviewed a paper prepared by management setting out the accounting implications and disclosures included in the 2016 Financial Statements following the agreement reached with the outsourced mortgage processing services provider in February 2017.

1.5 Fair Values of Financial Assets and Liabilities
Management presented a paper on the basis of preparation and calculation of Note 38 to the Bank Financial Statements and Note 27 to the Company Financial statements and concurred with the note disclosure.

1.6 Effective interest rate
Management presented a paper to provide an overview of how effective interest rate (EIR) accounting is applied and the impacts on the Bank's accounts over recent periods.

1.7 Pensions
The Committee again debated the accounting treatment of both of the Bank's principal pension schemes, Pace and Britannia. It concluded that, as at 2016 year end, insufficient information was available to reliably account for the Pace pension scheme as a defined benefit scheme but the Bank would continue to reflect a liability in the balance sheet as in 2015 since agreement had been reached on a short term funding contribution.

The Committee considered papers prepared by management regarding the Britannia pension scheme and concluded that following changes effected to the scheme in 2016, the full IAS 19 surplus should be recognised on the Bank's balance sheet as at 31 December 2016.

1.8 Business separation
In line with previous years, 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 reports from management and considered the adequacy of the provision in the light of changes to assumptions and work performed to date. Consideration was also given to the types of provisions included within separation, both for restructuring due to data migration and for provision of service levels to customers.

1.9 Deferred tax assets
The Committee reviewed a paper prepared by management which noted that the agreed criteria to recognise deferred tax assets relying on future profitability had not been met. The paper also addressed the future utilisation of tax losses which represent the significant proportion of the potential unrecognised deferred tax asset.

1.10 Group Relief Debtor
The Committee discussed the measurement of the group relief debtor due from The Co-operative Group and reviewed a paper prepared by management setting out the key assumptions inherent in the calculation as well as changes to the repayment profile provided by The Co-operative Group which led to an increase in the Group Relief Debtor reported in the Annual Report and Accounts. The key judgements associated with the calculation of the Group Relief Debtor include assumptions on The Co-operative Group's capacity to realise the benefit of the tax losses surrendered by the Bank, the reliability of the repayment profile information provided by The Co-operative Group, the extrapolation of the repayment profiles provided by The Co-operative Group and future changes to tax legislation.

1.11 Accounting for Legacy Portfolio deleverage transactions
The Committee considered papers prepared by management which outlined the accounting for several Legacy Portfolio deleverage transactions which took place during 2016.

1.12 Derecognition of Financial Assets
The Committee noted that derecognition of the Bank's securitisation transactions undertaken in 2015 remained valid.

1.13 Sale of share in Visa Europe and valuation of remaining holding
The sale of Visa Europe was the subject of a paper, outlining the timing for the recognition of the profit on sale and basis of valuation of the resulting preference shares, potential loss share provision recognition, deferred consideration valuation and any potential future provisions. The Committee considered and challenged these assumptions and carefully considered the impacts of any post balance sheet events on the proposed disclosure and valuation

1.14 Britannia Fair Value Adjustments
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 assumptions associated with the unwind of the remaining Fair Value Adjustments were reviewed.

1.15 Intra group transfer of assets
The Committee considered a paper prepared by management which included the impact of the transfer of certain net assets from subsidiaries of the Bank to the Company (which has no impact at the consolidated Bank level).

1.16 Intangible Assets
The committee reviewed an analysis prepared by management outlining the intangible assets held by the Bank as at 31 December 2016 and concurred with the year-end carrying value.

1.17 Unadjusted Errors
The external auditors reported to the Committee the misstatements that they had found in the course of their work, including in respect of prior years; no material amounts remain unadjusted.

1.18 Fair, Balanced and Understandable
The Committee considered whether the Annual Report and Accounts 2016 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 Committee held to review and consider the Annual Report and Accounts in advance of approval by the Board.

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

1.19 IFRS 9
The Committee was updated as to the implementation of IFRS 9 including a review of the Bank's approach to IFRS 9, the work underway to implement IFRS 9 and the project status. A programme of periodic IFRS 9 updates to the Committee is in place.

2 Governance over accounting policy and judgements
The Committee considered the governance to support Financial Reporting Risk including the Accounting Policy Forum, which oversees accounting policy, and the Key Judgements Forum which reviews and challenges significant accounting matters.

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

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

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

The Audit Committee reviews and, where necessary, challenges management to ensure auditor objectivity and independence is not impaired. Fees for audit-related, non-audit services and audit expenses for the year amounted to £3.7m (2015: £3.9m). Details of the auditors' remuneration can be found in note 4 to the financial statements. The Audit Committee is satisfied that the overall levels of audit-related, non-audit fees and audit expenses 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.

The Audit Committee evaluated the performance since appointment, independence and objectivity of Ernst & Young LLP (EY) 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 Audit 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 EY.

During 2016, the external auditor provided the Audit Committee with a management letter summarising its main observations and conclusions arising from the year-end audit, half year reviews and any recommendations for enhancements to the Bank's reporting and controls. Mitigating actions were identified for implementation by the business. Internal Audit have been monitoring and tracking the implementation of these actions (with the exception of the actions arising from the specialist reviews, which are being tracked and validated by EY), with regular reporting to the Audit Committee on progress made.

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. The Executive Committee (ExCo) reviews performance against budget and forecast on a monthly basis and senior financial managers regularly carry out an analysis of material variances.

Responsibility for reviewing the effectiveness of the internal controls has been delegated to the Audit Committee by the Board.

The Audit Committee uses information drawn from 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 Audit Committee;
- the Risk Management Framework for reporting and escalation of control issues; and
- further objective assurance is provided by external specialists.

Risk Management, Internal Control and related Financial and Business Reporting
The Board and senior management are responsible for the continuous operation of an effective risk management framework based on a robust system of internal control. Such systems are designed to manage rather than eliminate the risk of failure to achieve the Bank's business and strategic objectives. The principal categories of risk confronting the Bank are described in greater detail in the Risk Management Report on page number 102 to 135, together with an explanation of the framework adopted by the Bank for managing risk.

The Board reviews the ongoing effectiveness of the systems of internal control through a combination of processes including:

- Regular reports/updates to the Board by the Chairmen of the Risk Committee and the Audit Committee;
- Regular reports to the Board, through the Audit Committee, from the Internal Audit function in respect of its independent audits of risk management processes and effectiveness of internal controls across the Bank. The Director of Internal Audit has direct access to the Chairman of the Audit Committee;
- Regular reports to the Board, through the Risk Committee, from the Risk function on the principal risks facing the Bank and the strength of the controls in place to mitigate such risks; and
- Reports to the Risk Committee on a regular basis presented by the Chief Risk Officer and the Director of Regulatory Risk, AML & Fraud. The Chief Risk Officer has direct access to the Chairman of the Risk Committee.

The Risk function, on behalf of the Board, performed a review of the effectiveness of the Bank's system of internal control. The 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 focused on:

- Creation of an evidence library that clearly demonstrates that the Board, Risk Committee, and Risk Oversight Committees (ROCs) discharge appropriate oversight and their responsibility, in maintaining sound risk management principals and internal control systems; and
- A review of the activities of the Committee against the terms of reference to provide evidence that key risk committees of the Bank have successfully discharged their responsibilities as described.

The review concluded that the Bank has an established RMF which is underpinned by an approved suite of Risk Appetites, Policies and Control Standards, which together support risk based decision making.

During 2016 the Bank's Risk Management and Internal Control Systems continued to be strengthened, as a result of the work undertaken on the embedding of the RMF including:

- A reassessment of risk appetite statements, key metrics and tolerance limits;
- Strengthening of Risk Governance through the re-alignment of the RMF responsibilities to the Senior Manager Regime (SMR) requirements and governance arrangements for the management of key RMF documentation have been streamlined;
- Enhancement to the Risk and Control Self-Assessment (RCSA) process which included improvement workshops between the Risk function and business entity owners aimed at better articulating risks, controls and testing to drive enhanced consistency;
- Further development of the Operational Risk Management System;
- Formal face to face Risk Management training for all employees & contractors; and
- Cultural enhancement by defining a Risk Training Strategy for all colleagues.

There have has been enhancements to Risk Reporting /Management Information (MI) through the formal governance committees of the Bank and increased Board awareness of the Principal and Emerging Risks. Effective Risk Management continues to be managed through existing governance routines of the Bank and in line with the SMR requirements.

Further re-organisation and strengthening of the Senior Risk Leadership Team has further developed the RMF and the re-structure of the Risk Function re-prioritised key activities to improve the three lines of defence.

A new model governance structure was implemented in 2016 to bring the Bank's internal governance process in line with industry standards and improve the Internal Ratings Based (IRB) control environment.

In 2016 significant progress has been made to meet regulatory expectations in the overall effectiveness and embeddedness of the RMF and Model Risk governance frameworks. Focus through 2017 will be to ensure robust risk and control activities remain an integral part of the Bank's business as usual (BAU) activities. There is an increased awareness of the RMF across the Bank and work continues to further embed all elements. Key activity includes:

- Further embedding of the RMF across the Bank through a normalisation process and collegiate working across all three lines of defence;
- Completion of the Model Remediation Programme with particular emphasis on Capital Regulation Requirements (CRR), Internal Ratings Based (IRB) and IFRS 9 model development and approval; and
- Focus on the development of Financial Reporting controls through further investment, reduction in manual interventions and automation of key activities.

The Board has received and reviewed regularly Risk MI and reporting in 2016. These components have highlighted the evolution of the RMF, key risks and issues and associated mitigation plans where required and provided Board with the oversight of Risk Appetite statement performance. The Board will continue through 2017 to monitor the continued evolution of the key components of the RMF in 2017.

Internal Audit

The Bank has an Internal Audit department comprising 18 in-house auditors supported by Internal Audit co-source arrangements with Deloitte LLP, PwC LLP, Grant Thornton UK LLP and Protiviti Limited. The co-source arrangements, which have been in place for a number of years, support the Bank's requirements for specialist skills or additional resources where it would be inefficient to resource internally. The Internal Audit team comprises staff with a mix of professional skills and qualifications, including qualified accountants and auditors with recent financial experience. Independence of the internal audit function is supported by the Internal Audit Director reporting directly to the Chairman of the Audit Committee and administratively to the CEO.

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

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 continues to develop with the progress of the Bank's turnaround. The audit plan is approved by the Audit Committee, and shared with the regulator.

During 2016 the scheduled internal audit reporting activity addressed a cross section of the Bank's key operations and internal control mechanisms. A total of 38 internal audit reports were delivered for the 2016 Internal Audit plan (2015: 49), which enabled the Audit Committee to assess the control environment overall and make recommendations for areas of focus to the Risk Committee and to the Board.

The Audit Committee is responsible for evaluating the performance of the Internal Audit function on a regular basis to ensure that the function complies with the Chartered Institute of Internal Auditors (CIIA) International Standards. In doing so, it will need to identify appropriate criteria for defining the success of Internal Audit. Delivery of the audit plan should not be the sole criterion in this evaluation.

An independent external quality assessment (EQA) was conducted in Q1 2016, with the results presented to the April 2016 Audit Committee. There were no high priority issues raised, and action plans are in place for suggested areas for improvements.

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

RISK COMMITTEE REPORT

Introduction by Risk Committee Chairman

'The Committee has continued to review and challenge the work being undertaken to improve the identification, mitigation and reporting of risks across the Bank as it continues to embed its Risk Management Framework. The Committee has focused on the remediation of the management and governance of Model Risk, the strengthening of the Risk function, the ongoing process of de-risking the Bank and the resolution of historic issues, including the remediation of conduct breaches. Significant progress has been made in the above and a number of other areas including the completeness, relevance and effectiveness of the reporting and Management Information (including Credit Management Information) considered by the Committee, controls over Financial Crime (including anti-money laundering) and the control framework relating to Conduct and Product Risk. Our IT platform is considerably more resilient following the completion of a key milestone in our programme with IBM. The overall risk culture of the organisation has improved considerably although it should be noted that the Bank continues to face significant risks which could affect its ability to implement its 2017–2021 Strategic Plan.'

Derek Weir
Risk Committee Chairman
08 March 2017

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	Date of appointment	Date of resignation
Derek Weir (Chairman)	Appointed 30 September 2014 Chairman since 26 January 2016	
Graeme Hardie	Appointed 21 August 2013 Stepped down as Chairman with effect from 26 January 2016	21 June 2016
Richard Coates	Appointed 21 August 2013	26 October 2016
William Thomas	Appointed 1 January 2014	
Charles Bralver	Appointed 23 April 2015	
Laura Carstensen	Appointed 1 July 2016	
Glyn Smith	Appointed 10 October 2016	

The Risk Committee met in total nine 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 Chief Financial Officer, the Director of Internal Audit and the General Counsel, 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 and the Chairman of the Risk Committee is a member of the Audit Committee. A member of the Remuneration Committee, Laura Carstensen, was appointed as a member of the Risk Committee to ensure that qualitative and quantitative advice is provided to the Remuneration Committee on risk weightings to be applied to performance objectives incorporated in executive remuneration. Prior to Laura's appointment to the Risk Committee, Graeme Hardie, as a member of both Remuneration and Risk Committees, had provided the cross over between the work of the two committees.

During 2016 the risk management structure continued to be strengthened alongside 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 and significant progress has been made. The Committee has 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 levels 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 in our industry such as strategy, product range and geographical coverage and the processes for managing those risks are described in detail on pages 102 to 135. The Principal Risks and Uncertainties which the Bank faces are described on pages 35 to 48.

Principal responsibilities and key areas of discussion

Principal responsibilities of the Risk Committee	Key areas discussed and reviewed by the Committee in 2016
Risk Management Framework • Review and challenge the design, implementation and effectiveness of the Risk Management Framework and recommend to the Board for approval. • At least annually, review and approve all new policies and those which have changed materially, supporting 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; and • adequate independence, being free from management or other restrictions. • Review the capability of the Bank to identify, assess, and manage new risk types.	• During 2016, the Committee actively discussed the significant progress made in embedding the Risk Management Framework and a regular update was provided to each meeting of the Committee held from and including April 2016 onwards. • The Bank commissioned an independent review by PwC in respect of good practice in embedding the Risk Management Framework and its recommendations were reviewed by the Risk Committee as part of its regular update on embedding the Risk Management Framework. • During 2016, the Committee reviewed and recommended the Risk Management Framework Policy to the Board for approval, and reviewed all new policies and those which had changed materially, supporting the RMF policy. • The Committee is due to consider the remit of the Risk function, its resources and independence during 2017.
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, the Chief Risk Officer presents a Bank Risk Report which provides a holistic view of risks across the Bank, including a summary of the key risk appetite trends. Individual detailed risk appetite returns are available to the Risk Committee for each meeting. • The Committee reviewed the embedding of risk into performance objectives and role profiles as part of the project to embed the Risk Management Framework. The Chief Risk Officer has reviewed risk weightings applying to executive remuneration structures and provided analysis to support Remuneration Committee activities in this area.
Risk appetite, limits and tolerances • Review, challenge and recommend to the Board for approval, all new risk appetite statements and at least annually, and more frequently as required, the Bank's risk appetite. • Review, challenge and approve any material changes to the Bank's risk appetite measures, tolerances and limits. • Review, challenge and exercise oversight of capital and liquidity management and advise the Board on strategy for capital and liquidity management. • Annually review, challenge and recommend to the Board for approval the ICAAP. • Annually review, challenge and recommend to the Board for approval the ILAAP. • Review, challenge and recommend to the Board for approval, submissions to competent authorities to be submitted in the Board's name.	• During the year, the Committee has continued to work with the Chief Risk Officer to continually evolve the quality of data reporting seen at Committee and Board levels in order to assist the Committee in its oversight of the monitoring of risk appetite, of risk acceptances and of risk events. The quality of the reporting has been completely overhauled and significantly improved during 2016. • The Committee reviewed, challenged and recommended to the Board for approval all new Risk Appetite Statements as part of the Risk Management Framework, as well as any material changes to the Bank's risk appetite metrics. • The Bank's Lending Discretion Framework was reviewed by the Committee in 2016, and the Committee reviewed, challenged and recommended the ICAAP and ILAAP to the Board for approval. • A regular update was provided on Model Risk to each meeting of the Committee held from and including April 2016 onwards. The Board received Senior Management Awareness training and training regarding Model Risk during the year. • 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. • Prior to recommending to the Board for approval, the Committee reviewed all material submissions to be provided to regulatory bodies. • The Committee has also engaged in extensive monitoring and oversight of the various remediation programmes currently under way across the Bank.
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 2016, discussed and monitored the Principal Risks and Uncertainties that faced the Bank. • The Committee reviewed the Strategic Plan Process for 2017-2021 and considered risks associated with it as highlighted by the Chief Risk Officer. • The Committee reviewed the Credit Risk Model Outputs of the 2017-2021 Strategic Plan and the Risk function reviewed the 2017-2021 Strategic Plan and reported its findings to the Board in January 2017.

Principal responsibilities of the Risk Committee	Key areas discussed and reviewed by the Committee in 2016
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.	• The Committee monitors all principal risks to the business using the Bank Risk Report which provides a holistic view of risk across the Bank, including significant and emerging risks and risk appetite trends. • During 2016, the Committee reviewed reports on potential breaches of risk appetite and proposed actions to resolve them. • The Committee considered key corporate exposures in terms of consolidated exposures and large exposure positions and risk mitigation. • The Committee has received regular reporting to help it review IT Risk and the remediation programme. • The Committee has considered reporting of emerging risks during the year together with regulatory feedback given to the Bank by the Prudential Regulation Authority and the Financial Conduct Authority and the plans agreed with regulators published to the market from time to time.
Regulatory risks and Compliance • Review and approve the annual regulatory risk and compliance 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 Chief Risk Officer and keep under review the adequacy and effectiveness of the Bank's regulatory risk function. • Receive prompt notification of any material adverse reports or sanctions by any competent authority.	• The Committee has challenged the development of certain risk models to support the attestation of, and achieving compliance with, the Capital Requirements Regulation. Further commentary can be found in the Principal Risks and Uncertainties section. • During 2016 the Committee reviewed, challenged and approved the 2016 Annual Conduct and Regulatory Assurance Plan. • The Chief Risk Officer attended Risk Committee meetings during the year providing regular reporting analysis. • The Committee is due to consider the remit of the Compliance function, its resources and independence during 2017.
Risk Reporting • Receive reports, findings and recommendations from the Enterprise Risk Oversight Committee (formerly 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.	• The Committee reviewed and recommended the Code of Conduct and Personal Investment Dealing Policy to the Board during the year. • Through the reporting from the Chief Risk Officer, the Committee continued to have access to the findings and recommendations of the Enterprise Risk Oversight Committee on matters referred to the Risk Committee or to the Board. • The Committee continues to work closely with the Audit Committee in determining the Company's Annual and Interim reporting.
Chief Risk Officer • Recommend to the Board the appointment and/or removal of the Chief Risk Officer. • Meet at least once a year with the Chief Risk Officer without the presence of management.	• The Committee Chairman regularly met with the Chief Risk Officer without the presence of management during the year. • Private sessions were held regularly between the Committee and the Chief Risk Officer.

NOMINATION COMMITTEE REPORT

Introduction by Nomination Committee Chairman

'During 2016 there were significant changes in the makeup of the Board and the Executive Committee, and the Nomination Committee was instrumental in the implementation of these changes. The Committee also continued to focus on Board composition and effectiveness. Succession planning remains a key constituent of the Committee`s work in order to ensure that the Board and the business has the skills, knowledge and experience as it seeks to deliver against its strategic aims.'

Dennis Holt
Nomination Committee Chairman
08 March 2017

Purpose of the Nomination Committee

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

Nomination Committee membership	Date of appointment	Date of resignation
Dennis Holt (Chair)	Appointed 25 February 2014	
Maureen Laurie	Appointed 30 June 2014	
William Thomas	Appointed 30 May 2014	1 July 2016
Aidan Birkett	Appointed 27 October 2015	

During 2016 the Nomination Committee focused on new appointments and the overall strengthening of the Board to meet the needs of the business and to be responsive to the regulatory environment in which the Bank operates. Much of the Committee's time was spent on the recruitment of a new Chief Executive Officer, a Chief Financial Officer and replacement Non-Executive directors. The Nomination Committee considers that the Board does consist of individuals with the right balance of skills, experience, knowledge and independence to provide strong leadership of the Bank. Biographies for each of the Bank's Directors can be found on pages 54 and 55.

During 2016 the Nomination Committee considered the replacement of Niall Booker as Chief Executive due to the expiry of his fixed term contract on 31 December 2016. Following an external and internal search process Liam Coleman was appointed as Deputy Chief Executive Officer in May 2016, having previously held the position of Director, Retail and Commercial Bank, on the basis that he became Chief Executive Officer upon the departure of Niall Booker.

The Committee oversaw an extensive search process which led to John Worth's appointment as Chief Financial Officer on 11 October 2016 in anticipation of the departure of John Baines.

The Committee also considered the appointments of new Independent Non-Executive Directors to the Board following Graeme Hardie and Richard Coates standing down in June and October 2016 respectively. Spencer Stuart, independent search consultants, were engaged to find a suitable replacement for Richard Coates who had been Chair of the Audit Committee and as a result of that search the Committee recommended the appointment of Glyn Smith who was appointed in October 2016. Additionally, the Committee considered the appointments of new members to the Executive Committee, including those of the new Chief Risk Officer and Human Resources Director.

The Bank has full regard to the benefits of diversity in all its elements, including gender diversity. During 2016 the Bank has continued to develop its Diversity Policy across the business creating colleague networking groups and driving awareness. In September 2016, following a recommendation from the Nomination Committee, the Board adopted an updated Board Diversity Policy based upon the earlier conclusions of the Women on Boards Report by Lord Davies which had recognised that greater efforts should be made in improving the gender balance of corporate boards and that quotas for female board representation were not the preferred approach. The Bank has committed to the diversity target for Board and senior staff roles envisaged by the Women in Finance Charter. The Charter helps improve opportunities and progression for women to ensure that talent rises to the top in the finance sector regardless of gender and the Bank will be publicly reporting on progress to deliver against its agreed targets to support transparency and accountability. 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 Non-Executive Director selection process during 2016 considered diversity amongst other attributes in the review of candidate selection criteria alongside the overarching requirement of appropriate skill set, experience and expertise.

At the end of 2016, of the 12 Directors on the Bank's Board, two were women (17%). During 2016, the Board's target for the minimum number of women on its Board was three. This was not achieved during the course of 2016 but it remains the aim of the revised Policy that there should be at least three female directors as soon as possible, preferably during 2017.

Principal responsibilities and key areas of discussion

Principal responsibilities of the Nomination Committee	Key areas formally discussed and reviewed by the Committee in 2016
• Regular review of the structure, size and composition of the Board. • Identify and nominate, for approval by the Board, candidates to fill Board vacancies having regard to the balance of skills, knowledge, independence, experience and diversity on the Board. • To review the independence, effectiveness and commitment of each of the Non-Executive Directors • Formulate 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. • Membership of the Audit, Remuneration and Risk Committees, and any other Board Committees. • Review the results of the Board performance evaluation including the time required from Non-Executive Directors. • The election or re-election of Directors by shareholders at the Annual General Meeting. • Review the leadership needs of the Bank and considering proposals in respect of these.	• Review of the structure, size and composition of the Board along with the skills, knowledge and experience of its members to ensure that Directors remain able and have sufficient time to discharge their duties and responsibilities effectively and to the high standard required. • During 2016 the Committee considered a number of nominations at both Board and Senior Executive level. The appointment of Liam Coleman as Deputy Chief Executive Officer in contemplation of him stepping up to the role of Chief Executive upon the departure of Niall Booker at the expiry of his fixed term contract on 31 December 2016 was the subject of extensive work on the part of the Committee. Glyn Smith was appointed as an Independent Non-Executive Director following the resignation of Richard Coates in October 2016. Following the resignation of John Baines as Chief Financial Officer in October 2016, John Worth was appointed on 11 October 2016. • Succession planning, including identification of external and potential external candidates for senior vacancies which may arise on a crisis-, short-, medium- or long-term basis. • The Board adopted the Board Diversity Policy recommended by the Committee in February 2015. The Committee reviewed the Policy in September 2016 and recommended a revised version to the Board for approval. The Committee will continue to monitor progress against the Policy during 2017. • 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. • The Committee reviewed the position of Directors offering themselves for election and re-election at the 2016 AGM.

VALUES AND ETHICS COMMITTEE REPORT

'I am pleased to present the report of the Bank's Values and Ethics Committee (V&E Committee) and my third as its Chair. In 2016, the Committee focused on further embedding ethical processes into the Bank's operations, ensuring that the mechanisms around screening our business and SME customers continue to be robust.

We stepped up our support for the Co-operative sector through our sponsorship of The Hive, a new business support programme for people wanting to start or grow co-operatives or community enterprises. I am delighted that the partnership has already been able to help 77 co-operatives and other groups.

I was delighted to see our 'My Money, My Life' campaign with Refuge bear results and recognition with two external awards for best Corporate Social Responsibility (CSR) programme. The campaign contributed to the formulation of a new code of practice which is being developed.

In March 2016, the Government also launched its 'Women in Finance' charter to increase the representation of women in the workforce across our sector. The Bank was proud to be one of the first signatories to the charter, setting a target of 40% of women in senior roles by 2020. The committee will be monitoring progress towards that target.

I was delighted to witness first-hand the work the Bank has been doing towards helping our most vulnerable customers in financial difficulty, through our ground-breaking pilot scheme with Citizens Advice Manchester. The relationship means a dedicated resource at Citizens Advice is committed to helping our customers with their whole financial situation, not just the debts they may hold with us, to get them back in to financial health.

The Bank has achieved much in 2016 and through the development of new and existing partnerships has delivered great value in communities throughout the UK. I look forward to building on this work in the coming year.'

Laura Carstensen
Values and Ethics Committee Chair
08 March 2017

Purpose of the Values and Ethics Committee
To recommend to the Board, for its approval and adoption, the 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	Resigned 29 November 2016
William Thomas	Appointed 13 December 2013	
Maureen Laurie	Appointed 30 June 2014	
John Baines	Appointed 1 July 2015	Resigned 11 October 2016
Liam Coleman	Appointed 1 July 2015	
Alistair Asher	Appointed 12 September 2016	

The Values and Ethics Committee was constituted on 1 November 2013, demonstrating the Bank's commitment to promoting and conducting its business in accordance with its established Values and Ethics. Laura Carstensen was appointed as Chair of the V&E Committee on 27 May 2014. The Co-operative Group has the right to appoint a nominee to the Committee whilst it indirectly or directly holds 20% or more of the ordinary shares of the Bank. On 12 September 2016 Alistair Asher was appointed as The Co-operative Group's representative on the Board and subsequently became a member of the V&E Committee as of the same date. The Chief Executive Officer regularly attends the V&E Committee.

During 2016 we were pleased to see the successful migration of customer and supplier screening processes from The Co-operative Group into the Bank, and also the transfer of the colleagues' volunteering programme. We are encouraged by the way customers have embraced the charitable giving element of our Everyday Rewards proposition launched in January 2016. This new form of customer giving, supplements that already contributed by the Bank through the affinity credit cards, and it raised £50,000 for our five charity partners in 2016.

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. As we move into 2017 we will be marking 25 years of our Ethical Policy which 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: www.co-operativebank.co.uk/aboutus/ourbusiness/ethicalpolicy

The Values and Ethics Committee oversaw the continuation of the award winning ‘My Money, My Life’ campaign. Launched in partnership with the national domestic violence charity Refuge, the campaign successfully shone a light on the issue of financial abuse in relationships and has received industry backing to explore a Code of Practice. The Code will provide a framework for banks to support victims of financial abuse. The Hive partnership with Co-operatives UK has steadily grown throughout the year. This partnership continues to demonstrate our support for the Co-operative movement through real support for those starting out in business.

The Committee also welcomed the many advancements in the treatment of vulnerable customers including the training of over 3,000 of our frontline colleagues, as well as the ground-breaking partnership with Citizens Advice Manchester which gave real help to almost 100 customers in the first two months of operation.

The Committee also reviewed the findings of an internal audit review into the practical operation of the Values and Ethics Policy in the Bank. The Audit Committee reviewed the approach of screening business customers and suppliers against the Ethical Policy. The findings led to strengthening the application of the screening process as the Bank took full ownership of the process from The Co-operative Group.

The Terms of Reference of the Committee were amended in March 2016 to give further clarity regarding the purpose of the Committee and to confirm that the Chairman of the Committee shall be a Non-Executive Director. The Terms of Reference of the Committee can be found at: www.co-operativebank.co.uk/aboutus/governance/terms-of-reference-for-board-committees

The Committee’s terms of reference require it to meet twice during the year; however, it agreed that it would meet more frequently in 2016 than required by its terms of reference. This was particularly as it focused 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. This is summarised in an annual report for approval by the Board. The Committee met four times during 2016. The Committee has agreed to meet four times during 2017 to ensure that more substantive items are reviewed together.

During 2016, the Chair of the Committee, together with each of the Chairs of the Remuneration and Risk Committees, engaged on a regular basis to ensure that there was consideration of the Bank’s Values and Ethics in the discussion and reporting of issues at Board and Committee meetings, including matters such as product reviews, policies and executive remuneration structures.

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

Principal responsibilities and key areas of discussion

<table>
<tr><th>Principal responsibilities of the Values and Ethics Committee</th><th>Key areas discussed and reviewed by the Committee in 2016</th></tr>
<tr><td>Values and ethical policies of the Bank
• Recommend to the Board for approval and adoption the Values and Ethical policies of the Bank.
• Represent, monitor and advise the Board on matters concerning the interests of customers, suppliers, employees and other stakeholders in their dealings with the Bank in line with the objects of the Bank as described in the Articles of Association having regard to:
(i) the legal and regulatory requirements applicable to the Bank and its directors;
(ii) the need for the Bank's operations to be commercially sustainable and profitable; and
(iii) the desirability of maintaining and enhancing the public reputation and image of the Bank.</td><td>• The Committee oversaw the continued adherence to the expanded Ethical Policy - the latest version of which was released in January 2015 in response to the 2014 ethical poll.
• The Committee reviewed and provided input into the creation of the Bank's annual Values and Ethics Report which features the key steps that the Bank took in 2015 to bring the Ethical Policy to life and embed ethics in to how it does business. The report can be seen here: https://www.co-operativebank.co.uk/assets/pdf/bank/news/values-and-ethics-report-2015.PDF
• 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.</td></tr>
<tr><td>Monitoring and reporting V&E related activities and alignment to the Bank's Ethical Policy
• Customer satisfaction levels (with a focus on service levels and on the product offering in the light of the Bank's Values and Ethics policies, in each case assessed by reference to relevant customer metrics).
• Alignment of treatment of the Bank's customers with its Values and Ethics.
• 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 Bank's approach to improving the social and environmental impacts of the Bank's own operations.
• Establishment of a clear ethical policy and ethical strategy informed by customer consultation that aligns with the commercial strategy and is reviewed annually.
• The extent to which executive remuneration policies are consistent with the Bank's Values and Ethics.
• 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 choice of suppliers, partners and third party relationships which should be informed by the Bank's Ethical Policy.
• In 2015, the Committee started the development of a 'Combined Reporting Pack' which would help the Committee to form an integrated view, and monitor over time: customer and supplier screening, volunteering, stakeholder management and quarterly government relations. This is now the Ethical Policy Compliance Report and it is presented to the Committee at each meeting.</td><td>• The Committee monitored complaints resolution and the level of improvement in customer satisfaction and receives regular updates from the Customer Service and Customer Insight teams.
• The Committee oversaw and considered aspects of the Bank's Vulnerable Customers work. For example, the Committee provided input into the Vulnerable Customer Steering Group and witnessed the success of the Citizens Advice partnership.
• The Committee was updated on the embedding of the Values and Ethics framework within the Bank. Particular focus has been placed on incorporating Values and Ethics in performance management, the induction programme and in ongoing e-learning modules.
• The Committee considered the allocation of 'Customers who Care' provision and oversaw the financial abuse campaign with Refuge, as well as Bank match funding. The Committee also supported bringing in house the colleague volunteering scheme and has been monitoring the uptake amongst colleagues which remains healthy.
• The Committee considered and evaluated the impact of a number of programmes on the Bank's Values and Ethics. The Committee also supported the Bank's commitment to an ethical workplace including monitoring its commitment to the Living Wage. The Bank continues to embed the Living Wage Employer accreditation it received in 2015.
• The launch of the Values and Ethics report took place in June 2016.
• The Committee has completed the development of a Values and Ethics scorecard to track the Bank's performance against Values and Ethics related metrics. The Committee will begin to use this in 2017.
• The Committee confirmed that remuneration policies remained a matter for the Remuneration Committee, but that they would continue to consider the impact on the Values and Ethics of the Bank.
• The Committee supported the ongoing piece of work to identify a territory to define the Bank in the minds of customers with an impact similar to that of the Ethical Policy when it was created 25 years ago.
• The Committee considered the content and wording of the Ethical Policy to ensure it remained current and appropriate. As a result of that review, there will be two additions to the wording of the policy in 2017 which will be communicated transparently</td></tr>
<tr><td>Statement to Co-operatives UK
• Monitor the Bank's compliance with its statement to Co-operatives UK.
• Report at least annually to the Board on the Bank's compliance with its statement to Co-operatives UK.</td><td>• The Committee monitored progress against the commitment to the three year partnership with Co-operatives UK – The Hive, a business support programme to promote social and economic development and enterprise in accordance with co-operative values.
• The Committee also hosted the Secretary General of Co-operatives UK at the second meeting of 2016.
• Regular meetings continue between management of the Bank and Co-operatives UK to monitor compliance with the statement.</td></tr>
</table>

BOARD EFFECTIVENESS

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

The UK Corporate Governance Code describes the principles by which a Board should consider, in a formal and rigorous manner, its own performance and that of its Committees and individual Directors.

In September 2015 the Board engaged Deloitte LLP to carry out an external review of the effectiveness of the Board and Board Committees of the Bank. The review was conducted using Deloitte`s Board effectiveness framework.

During autumn 2015, Deloitte commenced the following work for the purposes of the Review:
- Review of documentation;
- Interviews with members of the Board and key Executives;
- Observation of the Board, Risk, Audit, Remuneration and Values & Ethics Committee meetings; and
- Consideration of peer and best practices in order to bring insight and analysis.

The Board Effectiveness Review was delivered by Deloitte to the Board on 17 February 2016. The review recognised that the Bank had undergone a period of intense and fundamental change since 2013 and it was part-way through execution of its five year turnaround plan. The Bank had moved from 'crisis mode' to 'turnaround mode' where oversight was particularly focused on the material change and remediation programmes underway. Despite the Board being very new, with the longest-standing director having served less than three years, Deloitte observed a number of strengths, in particular the commitment of the Board during a period of intense and challenging activity. The Review identified a number of areas for improvement and the Board has put in place an action plan to address these areas.

In addition to the External Board Review, we also conducted an internal self-assessment of Board Committees during Q1 2016 based on a questionnaire completed by each Director. The outcomes from these various reviews were considered by the Board and action was taken where appropriate. During 2016, Aidan Birkett, as the Senior Independent Director, was responsible for the performance evaluation of the Chairman. The outcomes from these various reviews were put before the Board for consideration.

The Board held four Strategy Sessions which provided an opportunity for wide-ranging debate with senior management on a wide variety of topics during 2016.

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 process an individual training needs profile is designed for each Director, which is reviewed periodically. Throughout 2016 the Board continued to hold collective training sessions which were 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 all Directors to access, revisit and review copies of presentations and materials from formal development sessions.

The Chairman's role is to address the development needs of the 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.

Senior Managers Regime (SMR)
In response to the new requirements for regulated firms and the individuals within those firms set out in the Senior Managers Regime that came into force in March 2016, a dedicated SMR Programme was established within the Bank to ensure that the Bank fully addressed and implemented the new rules under the Senior Managers Regime.

All Directors have been briefed extensively and have received training in connection with the new requirements set out in the Senior Managers Regime.

Deloitte LLP was engaged during 2016 to provide advice and challenge to the SMR Programme and its implementation of the new rules to ensure this is aligned with industry best practice.

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 at each Board meeting to satisfy itself 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. The Board has put in place protocols to address potential conflicts arising from the appointment of the two Non-Executive Directors who are not independent for the purposes of the Code.

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 2016 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 2016 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 a procedure in place by which, with prior agreement, 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 which are owned by The Co-operative Group Limited. For information about the ownership of the Bank's ordinary shares, please see the Corporate Governance report – Relations with Shareholders on page 63.

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, in 2013, 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

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 the 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;

- the Strategic report includes a fair review of the development and performance of the business and the position of the Bank/Company and the undertakings included in the consolidation taken as a whole, together with a description of the Principal Risks and Uncertainties that they face; and

- the annual report and financial statements, taken as a whole, are fair, balanced and understandable and provide the information necessary for shareholders to assess the Bank/Company's performance, business model and strategy.

This responsibility statement was approved by the Board of Directors on 08 March 2017 and is signed on its behalf by:

Dennis Holt
Chairman
08 March 2017

DIRECTORS' REMUNERATION REPORT

Dear Shareholder,

I am pleased to present our report on Directors' remuneration for 2016.

Following the approvals received from shareholders at the 2016 AGM, the Committee adapted the Bank's policy to reflect the agreed minor amendment giving flexibility for Role Based Allowances to be paid in shares or share-like instruments, if required. I would like to thank shareholders for their strong support and feedback over the last year.

Our full Directors' remuneration policy, as approved by shareholders at the 2016 AGM, remains unchanged for 2017 and can be found on https://www.co-operativebank.co.uk/assets/pdf/investorrelations/annual-report.pdf

A summary of matters considered by the Remuneration Committee in 2016 is set out in pages 90 to 92. Throughout 2016, there has been a close emphasis on performance, capital conservation requirements and risk, both in the consideration of legacy events and looking forward as the Bank executes its plan. Progress continued in rebuilding the customer-based retail banking proposition, emphasising the Bank's values and ethics policy, and in delivering a number of key operational and strategic elements of the planned turnaround, including the critical separation of the Bank's IT systems from those of The Co-operative Group in accordance with our regulatory commitments. However, the effects of lower for longer interest rates, challenges to transformation projects and increasing capital requirements adversely affected the longer term outlook. Consequently, the Board approved the Bank's 2017-2021 Strategic Plan, which was subsequently reviewed and accepted by the Bank's regulators and which could influence the time by which capital compliance and profitability are achieved.

Variable pay represents a core part of the Bank's remuneration policy, as agreed by shareholders in 2015, providing a measurable basis to integrate and reward the achievement of annual milestones and the longer term recovery plan. As advised to shareholders last year, CRD IV restrictions introduced in 2016 constrain the Bank's ability to award variable pay, such that no annual bonus awards or vested LTIP awards may be paid out unless these additional regulatory requirements for capital compliance and profitability have been achieved.

Accordingly, the Bank reviewed the application of its pay policies in 2016 to comply with these new regulatory constraints and to ensure it could continue to provide competitive and justifiable levels of remuneration.

The Committee confirmed that, while remaining subject to CRD IV restraints, the approved policy framework would remain in place, but annual bonus awards would be suspended until the new CRD IV requirements were achieved. Individual levels of remuneration would continue to be tested against relevant market comparators and, although some rebalancing would be required, the Committee emphasised that the overall pay bill should not rise.

The Committee also considered all potential approaches to extending equity-based incentives to a wider population across the Bank. However, due to cost and complexity, the Committee concluded that continuing the existing LTIP policy for a small number of key executives would provide a stronger approach at this time. Accordingly, LTIP awards were granted in 2016 to 32 executives (2015:31) with performance conditions applying over an extended 5 year term, thus maintaining alignment to the Bank's recovery plan and to shareholder interests. Further details of the 2016 LTIP are set out below.

All LTIP awards from 2014 onwards include a standard performance condition that the relevant CET1 ratio must have been achieved before the award may vest and pay out. LTIP awards also remain subject to close monitoring against performance metrics, CRD IV compliance and profitability forecasts.

The Committee has emphasised that alignment to shareholder interests continues to be achieved through the annual bonus awards made for 2014 and 2015, payable in cash but tracked against the Bank's share price, as these are deferred in accordance with regulatory requirements. In 2016, this had the effect of reducing the value of deferral tranches released by 66% compared with values in 2015.

Planned Executive Director succession and a progressive restructuring of accountabilities for the Executive Committee and other senior roles allowed changes to remuneration to be achieved within current pay policy. This has resulted in a 19% reduction in Executive Committee annual cash pay to £8.7m in 2016 (£10.7m in 2015). This is forecast to reduce further to £6.5m in 2017, 39% lower compared with 2015.

The Bank's senior management and the Committee felt it was important to recognise the contribution of the wider workforce during 2016, and therefore also implemented a single year-end payment in respect of 2016 for staff below senior levels, equivalent to 3% of base salary, along with targeted adjustments to individual base salaries, where appropriate.

Overall, this restructuring of remuneration undertaken to address capital constraints resulted in an additional cost to the fixed pay bill of £3.6m, although the total pay bill fell from £157.6m in 2015 to £146.0m in 2016. The Remuneration Committee considers this to be proportionate and reasonable in these particular circumstances given the necessity of attracting and retaining skilled staff at all levels during the ongoing recovery plan.

Notwithstanding these limitations on variable pay and the suspension of annual bonus awards, there has been no relaxation of the Committee's attention to performance during 2016 in order to maintain focus on the longer term Plan. Risk policies and reporting processes have been further strengthened, with detailed quarterly reports from the Chief Risk Officer to the Remuneration Committee, and a regular structured review of material events by the Bank's Risk Adjustment and Individual Risk Adjustment Committees.

Malus and clawback policies continue in force, and are taken into account by the Bank's Individual Risk Adjustment Committee when considering the effects of major risk events before referral to the Remuneration Committee to consider any action required.

Chief Executive Officer and Chief Financial Officer Remuneration
The contracts of the former Chief Executive Officer, Niall Booker and former Chief Financial Officer, John Baines, concluded on 31 December 2016 and 15 October 2016, respectively, in accordance with the Bank's planned executive succession.

Niall Booker's contract was for a fixed term and as such he received no payment for loss of office, nor any payment in lieu of notice. In consideration of the application of CRD IV restrictions, no annual bonus was awarded to Mr Booker in respect of 2016. In line with our approved policy, the Committee granted a 2016 LTIP award to Mr Booker equivalent to 200% of salary. This award is subject to pro rating in respect of service during the performance term. The base value is, therefore, 66.67% of salary before performance measurement against the 2016 LTIP metrics and testing for capital compliance. Overall, Niall Booker's single total figure of remuneration for 2016 was £2.07m (2015:£3.85m). Further details can be found on page 92.

John Baines' Role Based Allowance was increased from £0.35m to £0.4m with effect from 1 January 2016 as part of the rebalancing of remuneration consequent upon the introduction of CRD IV restrictions. Upon conclusion of his contract, John Baines received a single payment in lieu of unexpired notice, equivalent to 9 months' salary. Mr Baines received no payment for loss of office. The Committee granted to Mr Baines a 2016 LTIP award equivalent to 100% of salary. The 2016 LTIP award is subject to service pro rating, and the base value is thus 27.78% of salary, before performance measurement and testing for capital compliance. Overall, Mr Baines' single total figure of remuneration for 2016, including payment in lieu of unexpired notice, was £1.43m (2015: £0.93m). Further details can be found on page 92.

Liam Coleman, Deputy Chief Executive Officer, was appointed Chief Executive Officer, on 1 January 2017, succeeding Niall Booker.
John Worth was appointed Chief Financial Officer on 11 October 2016, succeeding John Baines.

The remuneration agreed for both new Executive Directors is composed of fixed pay and a variable LTIP opportunity, with no annual bonus component, in accordance with the overall review of pay structures for CRD IV undertaken during 2016. Both Mr Coleman and Mr Worth were granted awards of 100% of their base salaries under the 2016 LTIP, in 2016. Further details of remuneration for Mr Coleman and Mr Worth can be found on page 92.

Remuneration Committee agenda for 2017
After another challenging year, which has also seen a significant restructuring of the Bank's senior management, the Remuneration Committee is satisfied that the revised executive pay arrangements put in place from January 2017, whilst meeting regulatory requirements and remaining in line with approved policy, continue to align performance priorities, risk and reward with the objectives of the Bank's plan for longer term, sustainable recovery and with the interests of shareholders.

During 2017, the Committee will continue its close monitoring of progress against plan and individual performance and capital compliance requirements. Allied to this focus on performance, the risk policies and reporting processes outlined above will be further embedded into the Committee's agenda.

The Committee intends to make further long term incentive awards to selected key staff in 2017. The level of such awards from 2017 onwards will be varied by individual performance in accordance with new regulatory requirements and will remain within the overall limits included in the policy approved by shareholders.

The Remuneration Committee will continue to consult with the Value and Ethics Committee on certain aspects of remuneration policy. With regard to pay relativities and requirements for gender-based pay reporting, the Committee will build on the Bank's work commenced in 2016 and its commitment to the Women in Finance Charter.

Maureen Laurie
Remuneration Committee Chair
08 March 2017

Remuneration Committee
The Remuneration Committee has the delegated responsibility to determine remuneration for the Executive Directors and the Executive Committee of the Bank. It sets, and recommends to the Board for approval, the overarching principles and parameters of the Remuneration policy across the Bank and applies the necessary oversight to ensure an overall coherent approach to remuneration is implemented for all employees. In addition, the Remuneration Committee undertakes to ensure compliance with the Prudential Regulation Authority's Remuneration Code and the UK Corporate Governance Code.

During 2016, the members of the Remuneration Committee were as follows:

Committee members	Date of appointment	Date resigned as a Committee member	Attendance (entitled to attend)
Maureen Laurie (Chair)	30 June 2014		14(14)
Dennis Holt	5 February 2014		14(14)
Laura Carstensen	30 May 2014		14(14)
Graeme Hardie	9 October 2013	21 June 2016	6(8)
Aidan Birkett	1 July 2016		5(5)

The Committee's regular business agenda requires 10 meetings during the year. In 2016 this requirement was expanded to 14 to allow consideration of the impact of CRD IV on remuneration policy, potential for equity- based alternatives and the restructuring of accountabilities and succession changes for the Executive Committee.

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 also provides advice on compensation and benefits to the Committee. The General Counsel and Company Secretary advises the Committee on corporate governance.

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

Advisor to the Committee
The Committee received support and advice from external advisors during the year. 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 fees paid to them in 2016. Fees are charged based on the scope and requirements of the work, as agreed with the Committee or the Bank as a whole. Deloitte LLP is a member of the Remuneration Consultants Group and, as such, voluntarily operates under the code of conduct in relation to 'executive remuneration consulting in the UK'.

The total fee paid in 2016 to remuneration advisors for remuneration-related advice to the Committee was:

Name	2016 Fees £000s	2015 Fees £000s
Deloitte LLP[1]	**112**	128

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

The Committee last reviewed the provision of advice in 2015 and confirmed that Deloitte would remain as advisor during 2016. The Committee has since confirmed that Deloitte will continue to provide advisory services to the Bank, with a full review of advisory support to be undertaken in 2017.

Principal responsibilities and key areas of discussion

Principal responsibilities of the Remuneration Committee	Key areas discussed and reviewed by the Committee in 2016 include

Remuneration policy
• Policy and contractual terms including salary, benefits and pension:
  • Set and recommend to the Board for approval, the overarching principles and parameters of the Remuneration policy across the Bank to ensure an overall coherent approach to remuneration in respect of all employees. Ensure that all relevant legislation, regulatory requirements and guidance on remuneration practice are considered and complied with when setting the Remuneration policy.
  • Support the Chairman of the Committee in overseeing the development and implementation of the Bank's Remuneration policy and supporting practices.
  • The Remuneration policy should have regard to the risk appetite of the Bank, whilst being consistent with effective risk management principles, be aligned to the Bank's long term strategic goals, and comply with relevant applicable legislation.
  • Review at least annually the ongoing appropriateness and relevance of the Remuneration policy and exercise its judgement in the application of the remuneration framework and policies to promote the long term success of the Bank.
	• The Committee reviewed the Bank's remuneration policies, with regard to CRD IV restrictions introduced in 2016, constraining the Bank's ability to award variable pay.
	• In view of these new regulatory constraints, the Committee considered all potential approaches to ensure appropriate pay structures and levels of remuneration are in place across the Bank.

Material Risk Takers • Review and agree the Remuneration policy and decisions relating to remuneration, including variable pay, performance related payments and pension arrangements, for any employees, present and prospective, in senior management roles, risk takers and staff in control functions that are included on the Bank's register of Material Risk Takers and therefore subject to the Remuneration Code. • Seek advice from the Board's Risk Committee, the Chief Risk Officer (by way of an annual report from the Chief Risk Officer) and consider the impact of Income Recognition and Asset Classification and provisioning (IRAC) on the risks arising from the remuneration policies for the purpose of the ICAAP within the key areas discussed and reviewed by the Committee in 2016 and other regulatory matters and specific risk adjustments to be applied to performance objectives of any Material Risk Takers, set in the context of incentive packages.	• The Committee strengthened the review process for Remuneration Policy Statement (RPS) reporting to the PRA and in doing so approved the list of designated Material Risk Takers in 2016 (74 as at 31 December 2016, including leavers and joiners during the year). • Risk policy reporting processes were further strengthened, with detailed quarterly reporting to the Committee from the Chief Risk Officer, together with a structured review and consideration of material events by the Bank's Risk Adjustment Committee and Individual Risk Adjustment Committee.
Executive Directors and the Executive Committee (the Executive) Having regard to the overarching principles and parameters of the Bank's remuneration policy: **Policy and contractual terms:** • Establish, implement and maintain the Bank's policy on all aspects of the remuneration of the Executive present and prospective, including pension rights and any compensation payments. • Review at least annually the on-going appropriateness and relevance of the Remuneration policy. • Oversee contractual arrangements and approve the principal terms and conditions of employment. • Ensure that contractual terms on termination, and any payments made, are fair to the individual, and the Bank, that failure is not rewarded and that the duty to mitigate loss is fully recognised. • Within the terms of the agreed policy and in consultation with the Chair and/or Chief Executive, as appropriate, determine the total individual remuneration package of each Executive and the Chair, ensuring full compliance with the relevant legislation and regulatory requirements. • Ensure that the remuneration of each Executive (including any payments for loss of office) is consistent with the most recently approved Remuneration policy. • Review salaries, normally at the start of the Bank's financial year, which may include reference to comparisons against the agreed financial services sector market policies. • Advise on any major changes in employee benefit structures throughout the Bank or its subsidiaries which relate to Executives.	• The contracts of the Chief Executive Officer and Chief Finance Officer were concluded as planned. • A revised executive pay structure was approved. Remuneration for the new Chief Executive Officer and Chief Finance Officer was approved, together with a review of Executive Committee accountabilities. The changes satisfy regulatory requirements, whilst ensuring performance priorities, risk and reward are all aligned with the Bank's strategic objectives.

Principal responsibilities of the Remuneration Committee	Key areas discussed and reviewed by the Committee in 2016 include
Incentive arrangements – annual and long term • Determine and review the policy for all incentive plans for approval by the Board and shareholders in accordance with the agreed Remuneration policy. • Approve any amendments to all incentive plans prior to obtaining any necessary shareholder approval. • For any such plans, determine each year whether awards will be made, and if so, the overall amount of such awards, the individual awards to be made and set appropriate performance targets. Ensuring that appropriate consideration has been taken for risk matters and events that have occurred both in year and in prior years. • Authorise payments under incentive plans, subject to the achievement of performance and balanced scorecard metrics, and underpin as applicable, and in accordance with the rules of the plan. • Authorise the application of the malus and clawback policy in relation to specific individual adjustments that may be agreed through the risk adjustment review process. • The Committee shall determine the design, performance measures and associated targets for any performance related pay schemes operated by the Bank in respect of Executives and Material Risk Takers and review individuals' performance against those targets and agree any payments proposed. • The Committee shall consider not less than annually whether or not it is necessary to apply malus and/or clawback in relation to the performance related pay schemes.	• With regard to the new regulatory constraints, the Committee considered all potential approaches to extending equity-based incentives to a wider population across the Bank. However, following an in depth analysis, a decision was taken not implement such a plan at this stage, due to cost and complexity. • The Committee approved the terms and performance measures of a Long Term Incentive Plan award for 2016 - 2020 with performance conditions applying over an extended 5 year term, thus maintaining alignment to the Bank's recovery plan. • With regard to the unvested 2014 and 2015 Long Term Incentive Plans, the Committee has monitored and recorded progress against the agreed financial and non-financial performance measures.

Directors' Remuneration policy

The Co-operative Bank's Remuneration policy for our Executive and Non-Executive Directors was approved by shareholders by way of an advisory vote at the 2016 AGM. It is intended that approval of the Remuneration policy will be sought at three year intervals, unless amendments to the policy are required, in which case further shareholder approval will be sought at the appropriate time.

Annual report on remuneration

The annual report on remuneration sets out how the Bank's policy was implemented in 2016, and how it will be implemented in 2017.

The annual report on remuneration will be put forward for shareholder approval by way of an advisory vote at the 2017 AGM.

Single total figure of remuneration - Executive Directors

The following table shows a single total figure of remuneration received in 2016 by Executive Directors in respect of qualifying service together with comparative figures for 2015, where applicable.

Audited

Executive Director	Salary £000s	Role Based Allowance £000s	Benefits[4] £000s	Pension £000s	Annual Incentive Plan £000s	LTIP £000s	Total Remuneration £000s
2016							
Niall Booker	1,325	500[5]	37	212	-	-	2,074
Liam Coleman[1]	311	53	10	50	-	-	424
John Baines[2]	615	691[6]	27	99	-	-	1,432
John Worth[3]	185	33	6	18	-	-	242
2015							
Niall Booker	1,255	1,285	32	201	502	576[7]	3,851
John Baines	400	350	18	64	100	-	932

1. Liam Coleman was appointed as an Executive Director on 11 July 2016. Figures set out above for 2016 salary, pension and benefits relate to his part year qualifying service as an Executive Director.
2. John Baines left the Bank on 15 October 2016. Figures shown above represent pro-rated amounts paid up to that date, together with amounts representing payment in lieu of notice (PILON).
3. John Worth was appointed as an Executive Director on 11 October 2016. Figures set out above for 2016 salary, pension and benefits relate to his part year qualifying service as an Executive Director.
4. Figures shown for benefits include cash car allowance and the value of benefits in kind such as private medical insurance, life insurance, health screening and permanent health insurance. Executive Directors are also reimbursed for expenses incurred for business reasons. Any tax that arises on the reimbursed expense is paid by the Bank
5. Niall Booker's Role Based Allowance remained unchanged from the figure agreed in June 2015. The figure shown in the table is the total amount paid during 2016, which includes both the payment in respect of the final quarter of 2015 and the full year payments for 2016.
6. John Baines' Role Based Allowance was increased from £350k to £400k with effect from 1 January 2016. The figure in the table is the total amount paid in 2016, which includes the payment in respect of the final quarter of 2015, the full year payments for 2016 and a proportion of the amount paid in lieu of notice (PILON).
7. In addition to this amount and as disclosed in our previous Directors' Remuneration report for 2014, one-third of the Long Term Incentive Plan award granted to Niall Booker in 2013 (representing performance for 2013) remained subject to the original performance measures of The Co-operative Group, with vesting of this one-third at the discretion of The Co-operative Group Remuneration Committee. The Co-operative Group Remuneration Committee subsequently reported to The Co-operative Bank its discretion that 85% of this one-third of the 2013 Long term Incentive Plan shall vest, resulting in an award to Niall Booker of £340,000 payable by The Co-operative Group, being satisfied in cash and subject to the provisions of the Remuneration Code.

Additional information in respect of each element of single figure of remuneration
The aggregate single total figure for 2016 for Executive Directors (£4.2m), is lower than 2015 (£4.8m). This aggregate figure reflects the appointments during the year of Liam Coleman and John Worth as successors to Niall Booker and John Baines, respectively.

Salary
Liam Coleman became Deputy Chief Executive Officer on 1 May 2016 and was appointed to the Board as an Executive Director with effect from 11 July 2016. His base salary was £0.6m, effective 1 May 2016.

John Worth was appointed Executive Director on 11 October 2016.

Role Based Allowance (RBA)
Niall Booker's Role Based Allowance remained unchanged since 1 July 2015 at £0.4m per annum. John Baines' Role Based Allowance was increased from £0.35m to £0.4m per annum with effect from 1 January 2016 as part of the wider restructuring of remuneration policy following the introduction of CRD IV constraints.

Pensions
Executive Directors received a cash allowance equivalent to 16% of salary in lieu of employer pension contributions in line with our approved policy.

Benefits
Benefits include car allowance, private medical insurance, life insurance, health screening and permanent health insurance.

Executive Directors' variable pay 2016

Annual Incentive Plan (AIP) awards
The Bank's policy includes a discretionary annual bonus plan, the Annual Incentive Plan (AIP). The Bank is currently constrained under the requirements of CRD IV regulations and therefore no AIP awards were made for 2016.

Long Term Incentive Plan (LTIP)
No awards vested during 2016 under the existing long term incentive plans.

Long Term Incentive Plan awards granted during 2016
The Remuneration Committee decided to grant awards under the 2016–2020 Long Term Incentive Plan to all four Executive Directors who served during 2016, taking into account contractual obligations and constraints on variable pay affecting AIP awards.

The award granted to the former Chief Executive Officer had a face value at grant date of 200% of salary. This will, however, be pro-rated to reflect that Niall Booker left the Bank at the end of the first year of the three year performance period, such that the base value of the award, before performance measurement and testing for capital compliance, is 66.67% of salary. The award granted to John Baines had a face value at grant date of 100% of salary. This will, however, be pro-rated to reflect his leaving date of 30 September 2016, such that the base value of the award, before performance measurement and testing for capital compliance, is 27.78% of salary.

Liam Coleman and John Worth were each granted awards with a face value at grant date of 100% of salary. The 2016 Long Term Incentive Plan is subject to the following performance measures.

Performance measures	Weighting	Threshold	On-target	Maximum vesting
Cost:Income Ratio	25%	25% of award vests for cost:income ratio of 67.6%	60% of award vests for cost:income ratio of 60.8%	100% of award vests for cost:income ratio of 55.3%
Absolute TSR per share	25%	25% of award vests for absolute TSR per share of 8% p.a.	60% of award vests for absolute TSR per share of 12% p.a.	100% of award vests for absolute TSR per share of 20% p.a.
Total Bank Profitability	20%	25% of award vests for 'Profit before Tax' of £86.3m	60% of award vests for 'Profit before Tax' of £95.9m	100% of award vests for Profit before Tax' of £105.4m
Total Financial measures	**70%**			
Risk and Control	10%	Performance against strategic measures will be assessed by the Remuneration Committee using individual scorecard ratings ranging from 1 – 10, with 50% of the award vesting at the threshold rating of 5. The detailed targets within each measure are not disclosed as these are deemed to be commercially sensitive. Retrospective disclosure will be provided in the 2019 Directors' Remuneration report, subject to commercial sensitivity no longer remaining.		
People	10%			
Customer	10%			
Total Strategic Measures	**30%**			
Total	**100%**			

The award takes the form of cash, which is linked to the Bank's share price and is subject to the Bank's CET1 ratio being maintained at or above the regulatory minimum through the three year (2016–2018) performance period. Failure to meet the minimum regulatory CET1 hurdle will result in a 0% pay out, irrespective of the levels of performance against any other targets. Following a further 24 month qualifying period, an additional test for capital compliance will be conducted to determine whether and to what extent awards can be paid out, in accordance with CRD IV regulations.

2014 and 2015 Long Term Incentive Plans

The transitional 2014 and 2015-2017 Long Term Incentive Plans, granted to Executive Directors in 2015, remain in place. Vesting and any pay-out is subject to achievement of the relevant performance conditions for these plans, maintenance of the Bank's CET1 ratio equal to or greater than 7%, the Bank's underlying financial performance and compliance with the capital and profitability requirements of CRD IV.

The following two tables show the remaining deferred awards to Niall Booker and John Baines, from earlier Annual Incentive and Long Term Incentive Plans:

Niall Booker		
2015 AIP	Deferred bonus[1] - £301.2k	Deferred cash - £150.6k
		Deferred share-linked cash - £150.6k
2014 LTIP[2]	Face value: 100% of salary	£1.25m
2015 LTIP[2]	Face value: 100% of salary	£1.25m

John Baines		
2014 AIP	Deferred bonus[1] - £109k	Deferred cash - £54.5k
		Deferred share-linked cash - £54.5k
2015 AIP	Deferred bonus[1] - £60k	Deferred cash - £30k
		Deferred share-linked cash - £30k
2014 LTIP[2]	Face value: 100% of salary	£400k
2015 LTIP[2]	Face value: 100% of salary	£400k

1. 60% of the 2014 and 2015 AIP awards were deferred over three years, with pro-rata vesting between the first and third anniversaries of the grant dates. The deferred element is comprised of 50% deferred cash and 50% deferred share-linked cash subject to a six month retention period, in line with regulatory requirements. The value of each deferred element will vary depending on the share price at the relevant vesting date.
2. Values shown represent the face values of the LTIP awards at the grant date. The value of each award will vary depending on performance and on the share price at the relevant vesting date.

Non-Executive Directors' remuneration - 2016

The tables below show the current fee structure and actual fees paid in 2016 to Non-Executive Directors.

Audited

	Base fee 2016 £000s	Committee Chairman fee[1] 2016 £000s	SID fee[2] 2016 £000s	Committee member fee[3,4] 2016 £000s	Total fees 2016 £000s	Total fees 2015 £000s
Dennis Holt	300				300	300
Laura Carstensen	60	25		22	107	95
Richard Coates[5]	50	24		13	87	95
Graeme Hardie[6]	32	2		8	42	95
Maureen Laurie	60	30		15	105	95
William Thomas	60			22	82	71
Derek Weir[7]	60	28		15	103	71
Charles Bralver	60			15	75	51
Aidan Birkett	60		30	20	110	37
Glyn Smith[8]	13	6		3	22	-
Alistair Asher[9]	15	-	-	4	19	-

1. Committee Chairman fee increased from £25,000 to £35,000 effective 1 July 2016. All the fees shown above are calculated on a pro-rated basis to reflect this. The fees are payable only once even if multiple committees are chaired.
2. Senior Independent Director (SID) fee increased from £25,000 to £35,000 per annum effective from 1 July 2016. The SID fee paid to Aidan Birkett above is calculated on a pro-rated basis.
3. Committee membership fees are payable for membership of up two Committees even if more than two Committees are attended.
4. A Non-Executive Director can be a member of various Committees such as Audit, Remuneration, Nomination, IPO, Values & Ethics and Risk.
5. Richard Coates stepped down as a Non-Executive Director on 26 October 2016.
6. Graeme Hardie stepped down as a Non-Executive Director with effect from 21 June 2016
7. Derek Weir was appointed Chair of the Risk Committee with effect from 26 January 2016
8. Glyn Smith was appointed as a Non-Executive Director from 10 October 2016 and as Chairman of the Audit Committee with effect from 26 October 2016.
9. Alistair Asher was appointed as a Non-Executive Director and a member of the Values & Ethics Committee from 12 September 2016. Mr. Asher's Director's fees are paid to The Co-operative Group.

Non-Executive Directors are reimbursed for expenses incurred for business reasons. Any tax that arises on the reimbursed expense is paid by the Bank. Non-Executive Directors do not participate in any of the Bank's employee benefit, pension or share plans.

Annual fees for Non-Executive Directors were reviewed by the Bank's Executive Directors during 2016, in consultation with the Chairman of the Board. There were increases to the Senior Independent Director fee and Audit, Remuneration and Risk Committee Chairman fees of £10,000 pa to reflect increased accountabilities and time commitments in these roles arising from the Senior Managers' Regime. Fees for membership of up to two committees, excluding Nominations and any special purpose committees, were unchanged, as shown below. All changes took effect from 1 July 2016.

The Bank clarified that upon termination of appointment, Non-Executive Directors shall only be entitled to such prorated fees for their services as may have accrued to the date of termination, except if the Bank terminates the appointment or requires the Non-Executive Director to resign in circumstances other than retirement for annual re-election and circumstances allowing immediate termination. If the Bank does not give or allow the Non-Executive Director (except the Director appointed by The Co-operative Group Limited) to give written notice in accordance with the terms of appointment, the Bank shall pay an amount in lieu of such notice subject to the appropriate deductions. The notice period required of Non-Executive Directors is three months, except for the Chair of the Audit Committee whose notice period is six months during the first two years' of the appointment and three months' thereafter.

Non-Executive Director fee structure

The following table sets out the fee structure for Non-Executive Directors that has been in place since 1 July 2016. No changes are proposed for 2017.

	Base fee £000s	Chairman of Audit, Remuneration and Risk Committees £000s	Chair of Values & Ethics Committee £000s	Senior Independent Director £000s	Committee membership (up to a maximum of two) £000s
Chairman of the Board	300	-	-	-	-
Other Non-Executive Directors	60	35	25	35	15

Payments for loss of office to Executive Directors and notice

John Baines received payment in lieu of unexpired contractual notice upon leaving the Bank on 30 September 2016. There were no payments made to Executive Directors in compensation for loss of office in 2016.

2017 Remuneration arrangements for Executive Directors

Arrangements for 2017 will reflect the review of Executive pay undertaken by the Remuneration Committee during 2016. While the new CRD IV regulations constrain variable pay, the Committee also considered the revised structure of the Executive Committee and its roles before approving proposals for Executive Directors. Given the restrictions on operating an Annual Incentive Plan, the Remuneration Committee deemed it appropriate to maintain and strengthen the focus on long-term performance, thereby further aligning reward with achievement of the Bank's strategic objectives and with shareholder interests.

The table below sets out the arrangements for the Executive Directors from 1 January 2017:

Executive Director	Salary £000s	Role Based Allowance £000s	Benefits £000s	Pension £000s	Annual Incentive Plan(AIP) £000s	LTIP (face value % of Salary)[1,2]	Total Remuneration (excluding LTIP award) £000s
2017							
Liam Coleman	900	450	27	80	-	150%[2]	1,457
John Worth	800	400	25	80	-	100%	1,305

1. Figures shown expressed as a % of salary represent the maximum face value of the LTIP award. Actual pay-outs are subject to various conditions being met upon completion of an initial 3 year performance period followed after two further years by satisfaction of CRD IV conditions one further year, taking the overall LTIP term to 5 years.
2. Liam Coleman has waived his entitlement to any LTIP award to be granted in 2017.The LTIP value shown above reflects the provisions of Mr Coleman's contract.

The following table shows the three year history of Chief Executive Officer's remuneration and for comparison purposes, the contractual provisions in 2017 for the Chief Executive Officer:

Year	Chief Executive officer	Salary £000s	Role Based Allowance £000s	Benefits £000s	Pension £000s	Annual Incentive Plan(AIP) £000s	LTIP (face value % of salary in year of award)[1]	Total Remuneration (excluding LTIP award) £000s
2014	Niall Booker	1,200	1,680	16	192	-	100%[2]	3,088
2015	Niall Booker	1,255	1,285	32	201	502	100%	3,275
2016	Niall Booker	1,300	400	37	208	-	200%[3]	1,945
2017	Liam Coleman	900	450	27	80	-	150%[4]	1,457

1. All figures shown as a % of salary are the face value of the LTIP award. Actual pay-outs are subject to performance conditions being met upon completion of the 3 year period followed by a further period at the end of which CRD IV compliance is measured and must be achieved before any award may be released.
2. Transitional 2014 LTIP award was granted to Niall Booker during 2015. This was disclosed in the 2014 Directors' Remuneration Report and received shareholder approval at the 2015 AGM.
3. Niall Booker's 2016 LTIP award shown is subject to service pro-rating for the performance period elapsed. Accordingly the base value of the award is equivalent to 66.67% of base salary, before performance measurement.
4. Liam Coleman has waived his entitlement to any LTIP award to be granted in 2017, and the value is shown for comparative purposes only.

Base Salary

Liam Coleman was appointed Chief Executive Officer on 1 January 2017. His annual base salary was increased on that date from £600,000 to £900,000 to reflect his appointment. John Worth's annual base salary of £800,000 took effect upon his appointment to the Bank on 1 September 2016.

The Executive Directors' base salaries will remain unchanged under the annual compensation review as at 1 April 2017.

Role Based Allowances
Liam Coleman's Role Based Allowance (RBA) was increased to £450,000 on 1 January 2017, reflecting his appointment as Chief Executive Officer from that date. John Worth's Role Based Allowance of £400,000 took effect upon his appointment to the Bank on 1 September 2016.

Pension and benefits for 2017
Pension and benefits arrangements for Executive Directors for 2017 will be in accordance with the Directors' Remuneration policy approved by the Bank's shareholders at the 2016 AGM.

Variable pay (AIP and LTIP)
Our proposed variable pay framework for 2017 is outlined below. The Bank is currently constrained from making Annual Incentive Plan awards and such payments are therefore suspended, as explained below. Long Term Incentive Plans remain in place. As previously announced, in 2014, shareholders approved the flexibility to pay variable remuneration up to twice the amount of fixed remuneration, and our framework for 2017 falls within this limit.

Maximum opportunity for 2017
The Chief Executive Officer and the Chief Finance Officer are eligible for variable pay awards, up to a maximum of 150% and 100% of base salary, respectively.

Annual Incentive Plan awards for 2017 financial year
CRD IV restrictions introduced in 2016 constrain the Bank's ability to award variable pay until capital compliance and profitability is restored. It is not, therefore, anticipated that an Annual Incentive Plan will operate for 2017.

Long Term Incentive Plan – 2017 awards
Liam Coleman has informed the Remuneration Committee that he has waived his entitlement to any LTIP award to be granted in 2017. Mr Coleman's contractual terms remain unchanged and he retains the potential to receive such an award, should one be granted, in subsequent years. The Remuneration Committee intends to make a long term incentive award in 2017 to John Worth, Chief Financial Officer and selected senior colleagues, covering the period 2017-19 inclusive.

All Long Term Incentive Plan awards granted in 2017 will be subject to malus and clawback provisions in line with regulatory requirements and the Bank's remuneration policy.

Performance measures and targets
For all Long Term Incentive Plan awards granted in 2017, the performance period will be three financial years from 1 January 2017.
The Committee intends that awards made in 2017 will vest by reference to a balanced scorecard of performance measures, listed below:
- Financial measures (70%)
- Strategic measures (30%)

Before any part of the 2017 Long Term Incentive Plan award can vest, the Committee must be satisfied that the Company's underlying financial performance justifies vesting, including satisfaction of the minimum regulatory requirement for CET1 ratio. Failure to meet this CET1 hurdle will result in a 0% pay out, irrespective of the levels of performance against the other targets. The targets are set for a three year performance period and are aligned to the Bank's Plan. Awards are also subject to capital compliance testing against CRD IV requirements. Any awards granted will be subject to deferral, malus and clawback, in line with regulatory requirements.

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

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

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

- Annual Incentive Plan (when applicable) – Corporate performance measures are consistent for Executive Directors and other employees; the level of bonus opportunity differs by role to reflect levels of accountability and contribution to results. Bonus awards payable to employees classified as Material Risk Takers for regulatory purposes are subject to deferral and part-payment in shares/share-like instruments in accordance with regulatory requirements.
- Long Term Incentive Plan – A limited number of senior Executives may be invited to participate in the Bank's Long Term Incentive Plan, having regard to accountability for delivery of the Plan and strategy. The terms of the Long Term Incentive Plan apply equally to all participants, including Executive Directors.

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

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

The Committee takes into account the views of significant shareholders when formulating and implementing the Remuneration policy and recognises and incorporates shareholder feedback.

Statement of voting at last AGM

The results of the vote on the Directors' Remuneration report at the 2016 AGM is shown in the table below.

Resolution		Votes for	% of votes cast	Votes against	% of votes cast	Total votes validly cast	Votes as % of issued ordinary share capital[1]	Votes withheld
2	To approve the Directors' Remuneration Report as set out on pages 88 to 101 (inclusive) of the Company's annual report and accounts for the financial year ended 31 December 2015	349,523,523	95.4%	16,864,462	4.6%	366,387,985	81.1%	0
3	(a)To re-approve the Directors' Remuneration policy as referred to on page 87 of the Company's annual report and accounts for the financial year ended 31 December 2015 and as set out fully on page 78 of the Company's annual report and accounts for the financial year ended 31 December 2014, which re-approval takes effect immediately after the end of the 2016 AGM and (b) To approve an amendment to the aforementioned Directors' Remuneration policy by amending the operation of the role based allowances to clarify that they will be kept under ongoing review with regard to regulatory changes and to enable them to be delivered in shares or share-like instruments as well as cash, as set out in the note to Resolution 3, which approval takes effect immediately after the end of the 2016 AGM.	349,523,523	95.4%	16,864,462	4.6%	366,387,985	81.1%	0

1. 451,456,510 ordinary shares, being the Bank's issued voting share capital as at 6.00pm on 17 June 2016, 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.

Pillar 3 disclosures on Material Risk Takers

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

Under the implementation of the European Capital Requirement Directive (CRD IV), new rules on remuneration were introduced with effect from 1 January 2014, and the definition of Material Risk Takers was revised. As part of these changes, the 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 2016, 74 Material Risk Takers were identified within the Bank according to the new criteria. This list was approved by the Remuneration Committee. Material Risk Takers are subject to the PRA Remuneration Code provisions which are applied in their remuneration arrangements and include:

- the deferral of at least 40-60% of their variable remuneration over a period of at least three years;
- the delivery of at least 50% of their variable remuneration in the form of shares or share-linked instruments, e.g. cash linked to the Bank's share price; and
- risk adjustment of any variable remuneration award, including: malus/clawback on Annual Incentive Plan, Deferred Bonus Plan and Long Term Incentive Plan awards. In particular, for any award made on or after 1st January 2015, clawback may apply for up to seven years following award.

While operating under the CRD IV restrictions on variable pay, the Bank will not be offering an Annual Incentive Plan. The above requirements will be addressed, as they apply, purely to LTIP awards.

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, reporting through the risk governance structure 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 2016 performance year.

1. Aggregate remuneration – by division

	2016	
Division	**Number of Material Risk Takers**	**Total Remuneration[2] £m**
Retail & Business Banking[1]	18	11.7
Corporate Functions	56	15.4
Total	**74**	**27.1**

1. CEO included in Retail & Corporate Banking division, Non-Executive Directors included in Corporate Functions.
2. Total Remuneration is the amount of remuneration paid during the year i.e. pro-rated for joiners and leavers.

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

	2016	
	Number of Material Risk Takers	**Total Remuneration £m**
Senior Management[1]	27	17.6
Other	47	9.5
Total	**74**	**27.1**

1. Senior Management consists of Non-Executive Directors, Executive Directors and Executive Committee members only.

3. Aggregate remuneration – by fixed/variable remuneration

	2016	
	Senior Management £m	**Others £m**
Total fixed remuneration[1]	10.9	7.5
Total variable remuneration:	-	-
Cash bonus (AIP)[2]	-	-
Deferred bonus (DBP)[3]	-	-
Long Term Incentive Plan (LTIP) [4]	6.7	2.0
Total	**17.6**	**9.5**

1. Includes pension contribution
2. There were no AIP awards made in 2016 due to CRD IV constraints
3. There were no deferred bonus awards made in 2016.
4. Long Term Incentive Plan award for 2016 shown at Face Value

4. Aggregate remuneration – deferred remuneration

	2016	
	Senior Management £m	**Others £m**
Unvested deferred remuneration from previous years[1]	1.6	0.8
Deferred remuneration reduced in 2016 through performance adjustments	-	-
Deferred remuneration awarded in 2016[2]	6.7	2.0
Deferred remuneration from previous years paid out in 2016[3]	(0.1)	-
Deferred unvested remuneration outstanding at 31 December 2016	8.2	2.8

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

5. Aggregate remuneration – sign-on and severance payments

	2016		
	Number of beneficiaries	Senior Management £000s	Others £000s
Sign on payment[1]	2	-	239
Severance Payment[2]	4	180	24

1. No sign-on payments were made in 2016. Two buy-out agreements for new hires in 2016 were made, totalling £239k. These payments were made to compensate the employee for forfeited bonus opportunity when joining the Bank.
2. There were 4 severance payments made in 2016 totalling £204k.The largest single payment was £180,000.

6. Aggregate remuneration – High earners by band

Number of staff with total remuneration of EUR 1 million or more in 2016, by band[1]	2016
€1m – €1.5m	2
€1.5m – €2m	1
€2m – €2.5m	1
€2.5m – €3m	-
€3m – €3.5m	-
Above €3.5m	1

1. In accordance with Article 450 of the Regulation under CRD IV, the reporting of aggregate remuneration - high earners by band is prepared in Euros; using the rates published by the European Commission for Financial Programming and Budget for December 2016 (1 GBP is equal to 1.17904 Euro).

Risk Management

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RISK MANAGEMENT

1. Risk management objectives and policies

1.1 Overview

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

During 2016 the Bank continued to review its RMF which focused on aligning roles and responsibilities between the 1st and 2nd lines of defence, updating the Bank's policy framework and the Bank's committee structure.

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

1.2 Approach to risk management

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

- 1st Line - The Bank's business teams are the Risk Owners (ROs) and sit within the 1st Line. ROs are responsible for owning and managing all risks within the business within defined appetites, ensuring supporting procedures are written, and are responsible for reporting the performance, losses, near misses and status of risks through governance. ROs are also responsible for the design, maintenance and testing of the control environment;

- 2nd Line - The Bank's Compliance and Risk functions act as the 2nd Line of defence. The Risk Framework Owners (RFOs) generally sit within the 2nd Line and where there are exceptions for some specialist areas, and the RFO sits within 1st Line (for example; Legal and Financial Reporting), the 2nd line Risk Function will provide oversight over the RFO activities. RFOs are accountable for ensuring there is an appropriate risk framework, oversight activity, challenging and monitoring the implementation of the risk framework and underlying Policies and Control Standards; and

- 3rd Line - The Bank's Internal Audit function assesses the adequacy and effectiveness of the Bank's control environment and independently challenges the overall management of the RMF.

1.3 Risk management strategy and appetite

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

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

1.4 Principal Risk Categories

The Bank has an established Risk Management Framework which is defined within the Risk Management Framework Policy which has established principles for managing risk throughout the organisation. It sets out the principles by which the Bank defines the risk taxonomy, identifies processes, ownership, responsibilities and the risk oversight required to support effective implementation across the Bank.

However, there are four main constituent risk types that cover all the risks within the framework taxonomy – this is articulated within the table below:

Principal Risk	Definition	Risk Taxonomy
Capital risk	Capital risk is defined as the risk that the Bank's regulatory capital is inadequate to cover its capital requirements.	• Credit Risk • Model Risk • Market Risk • Pension Risk • Strategic Risk • Operational Risk
Operational risk (Subset of Capital risk)	Operational risk is defined as the risk of loss resulting from inadequate or failed internal processes, people and systems or external events.	• Regulatory Risk • Conduct Risk • Product Risk • Fraud Risk • AML Risk • Financial Reporting Risk • Information & Data Risk • Payments Risk • Legal Risk • Technology Risk • Change Risk • People Risk • Third Party Supplier Risk • Physical Assets Risk (including Health & Safety) • Insurance Risk • Business Continuity Risk
Liquidity and funding risk	Liquidity and funding risk is the risk that the Bank is unable to meet its obligations as they fall due or can only do so at excessive cost.	
Reputational risk	Reputational risk is the risk of damage to how the Bank's reputation, brand or image are perceived by its internal or external stakeholders as a result of its conduct, performance, or the impact of operational failures or other external issues.	

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

The Board has established Board Committees and senior management committees as well as appropriate forums to oversee the RMF, including identifying the key risks facing the Bank and assessing the effectiveness of any risk management actions.

Committee	Reports to:	Risk focus
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 enable 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.
Risk Committee of the Bank (RC)	Board	RC is responsible for the review and reporting of its conclusions to the Board in respect of the Bank's risk appetite and RMF, taking a forward looking perspective and anticipating changes in business conditions.

Committee	Reports to:	Risk focus
Executive Committee (ExCo)	CEO	ExCo is responsible for defining and successfully implementing the Board approved strategy by monitoring and managing delivery against plan and applying appropriate risk management actions to emerging risks.
Transformation Committee (TC)	ExCo	TC is responsible for ensuring the successful implementation, prioritisation and funding of projects across the Bank in line with the Board's Strategic Plan. As such the committee assists the Chief Operating Officer (COO) in prioritising projects within available resources and agreed investment budgets, overseeing the Bank's change funding position and the Bank's change policies, as well as processes and standards to effectively manage the Bank's change risk profile.
Executive People Committee (EPC)	ExCo	EPC provides assurance on the effectiveness of the Bank's people management policies and procedures. EPC is responsible for the review of key people data within the Bank such as headcount, retention and to oversee the hiring of senior, business critical or regulatory roles and all remuneration policies below the Executive level. There is also a Diversity Committee reporting into EPC.
Asset and Liability Committee (ALCO)	ExCo	ALCO is primarily responsible for overseeing the management of capital, market, earnings, liquidity and funding risks. Its responsibilities include identifying, managing and controlling the 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 and recommending relevant principal risk policies, detailed risk appetite limits for approval and approval of all product pricing proposals. There is also a Pension Strategy Committee reporting into ALCO.
Enterprise Risk Oversight Committee (EROC)	ExCo	EROC provides a mechanism to ensure all the Bank's risks are reviewed, challenged and approved in line with decisions made at the ExCo (with escalation to RC where required). EROC achieves some of its objectives through delegating responsibility to sub-committees, Conduct & Regulatory Risk, Operational Risk and Credit Risk Oversight Committees. The sub-committees will approve, discuss or note papers and escalate to the EROC where relevant or where required by governance. EROC will escalate where appropriate to the Board via RC.
Models & Rating System Oversight Committee (MRSOC)	ExCo	MRSOC is an executive sub-committee authorised by and reporting into the Bank's ExCo with an additional reporting channel via the Chief Risk Officer (CRO) to RC. The primary objective of the committee is to support the CRO in ensuring, on an ongoing basis, that the Bank's rating systems and material models are operating effectively. This includes providing executive level review and challenge of the Bank's model risk and the impact of model risks on the Bank's business model and strategy.
Technology Steering Committee (TSC)	ExCo	TSC acts to support the Chief Technology Officer (CTO) in developing and executing the Bank's IT strategy. The TSC provides a forum for Executive input to strategic IT decisions, policy, planning and prioritisation, maintaining alignment between IT strategy and Business strategy. TSC assesses potential risks and benefits from future technology changes.
Project Oversight Committee (POC)	TC	POC is responsible for overseeing and challenging the delivery of the Bank's Change Portfolio ensuring there is clarity of delivery outcomes, that benefits are delivered within the agreed time, cost and quality thresholds, that sponsors have the necessary executive support to deliver successfully and that key risks and issues threatening delivery are being effectively managed.
Bank Design Authority (BDA)	TC	BDA is a forum that acts as the guardian of how the Bank's Strategy is implemented. The forum oversees and directs strategic design choices relating to proposed changes to the Bank's operating model from a customer, business process, colleague, data, technology, finance, and risk perspective.
Strategic Transactions Committee (STC)	ALCO	STC reviews, challenges and approves (where permitted within the authority delegated to it) strategic transactions designed to achieve a de-leveraging of the balance sheet in line with the strategy outlined by the Board for Non-core assets. In making its decisions it ensures that sanctioned deals are approved in line with delegated financial authorities and risk assessments are carried out by the CRO or other directors in the Risk function.
Credit Risk Oversight Committee (CROC)	EROC	CROC's purpose is to monitor significant credit risks and issues with the entire credit life cycle, the controls and management actions being taken to mitigate them and to hold to account the executives responsible for actions. This includes, but is not limited to, proposing, monitoring and reviewing the credit risk appetite (current and emerging) of the Bank ensuring that key risk exposures are managed within risk appetite, and reported to EROC, and that appropriate mitigating actions are taken; and that operational adherence to the RMF through a process of ongoing continuous improvement and review of the credit risk strategy is achieved while making recommendations to EROC as appropriate.

Operational Risk Oversight Committee (OROC)	EROC	OROC oversees the design and maintenance of the Bank's Operational Risk Framework and the risk control frameworks. In addition to this the OROC recommends to the CEO, CRO and the EROC relevant underlying policies and detailed risk appetite limits for approval.
Conduct and Regulatory Risk Oversight Committee (CRROC)	EROC	CRROC provides oversight of the Bank's RMF in respect of regulatory, conduct, fraud, anti-money laundering and product risks.
Model Risk Management Review Committee (MRMRC)	MRSOC	MRMRC is a sub-committee of MRSOC. MRMRC supports MRSOC in ensuring, on an ongoing basis, that the Bank's rating systems and models are operating effectively. This includes providing review and challenge to the outputs of the model Working Groups, reviewing assumptions, limitations, sensitivities, impacts etc. in light of the Bank's wider business model and strategy. The committee is required to authorise or reject Medium materiality models and to reject or recommend high materiality models to MRSOC.

A number of senior management committees are supported by either management forums or sub-committees. The purpose of these is to assist the senior management committees to exercise their respective mandate. They either do not hold any delegated authorities or decision making powers as these are retained by the respective senior management committee or they have some limited delegated authority for specific tasks. The key forums and sub-committees are:

Forums	Risk focus
Liquidity and Market Risk Forum (LMRF)	LMRF is a forum reporting to the ALCO. The role of the LMRF is to define the lower level governance requirements for liquidity and market risk across the Bank. The forum oversees and challenges all aspects of liquidity and market risk management and makes appropriate recommendations to ALCO as required.
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. CMF is responsible for making recommendations to ALCO as appropriate.
Secured Funding Review Forum (SFRF)	The primary monitoring of SFRF is via the forum and is responsible for making appropriate recommendations to ALCO as required.
Strategic Asset Review Committee (SAR)	SAR is a committee, established by Legacy Portfolio Operating Committee for the strategic review of Corporate Performing and Non-performing assets within Legacy Portfolio. Lending proposals presented to SAR are sanctioned within the Credit Discretion Matrix.

1.5 Risk Profile of the Bank

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

The Co-operative Bank plc	**Retail**	**Business Activities:** • Deposits • Credits and lending to retail	**Loans and advances to customers (£m)** 14,863.8	**RWAs (£m)** Credit risk: 1,919.9 Operational Risk: 506.8
	BaCB	**Business Activities**: • Lending to SME sector	**Loans and advances to customers (£m)** 498.0	**RWAs (£m)** Credit risk: 485.3 Operational Risk: 353.6
	Treasury and Other	**Business Activities:** • Cash flow, liquidity management, FX	**Credit risk balances (£m)** 4,814.3[1]	**RWAs (£m)** Credit risk: 1,498.4 Operational Risk: (52.6)[2]
	Non-core	**Business Activities:** • Historic corporate loans • Closed residential mortgage book	**Loans and advances to customers (£m)** 4,090.9	**RWAs (£m)** Credit risk: 2,040.4 Operational Risk: (75.7)[2]

1. Combination of Loans and advances to Banks, Investment securities and Derivative financial instruments.
2. The capital requirement for operational risk is calculated using three prior year's operating income; both Treasury and Non-core income has been a loss resulting in a negative calculation of RWA. CRR allows for positive income values in business line activity to be offset by negative income providing the overall total is not less than zero.

2. Credit Risk

2.1 Overview and credit exposure

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

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

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

Audited

31 December 2016	**Loans and advances to banks**	**Loans and advances to customers**	**Investment securities**	**Derivative financial instruments**	**Total**
Analysis of balance in notes	**15**	**16a**	**17**	**18**	
Gross balance	**836.9**	**19,575.0**	**3,551.9**	**425.5**	**24,389.3**
Less: allowance for losses	**-**	**(122.3)**	**-**	**-**	**(122.3)**
	836.9	**19,452.7**	**3,551.9**	**425.5**	**24,267.0**
Analysis of credit risk exposure					
Not impaired	**836.9**	**18,855.8**	**3,551.9**	**425.5**	**23,670.1**
Impaired	**-**	**719.2**	**-**	**-**	**719.2**
	836.9	**19,575.0**	**3,551.9**	**425.5**	**24,389.3**
Credit commitments (incl. Derivative and Contingent Liabilities)	**-**	**2,441.7**	**-**	**-**	**2,441.7**
Gross credit risk exposure	**836.9**	**22,016.7**	**3,551.9**	**425.5**	**26,831.0**
Less: Allowance for losses	**-**	**(122.3)**	**-**	**-**	**(122.3)**
Net credit risk exposure	**836.9**	**21,894.4**	**3,551.9**	**425.5**	**26,708.7**

31 December 2015	Loans and advances to banks	Loans and advances to customers	Investment securities	Derivative financial instruments	Total
Analysis of balance in notes	15	16a	17	18	
Gross balance	871.0	19,935.6	4,894.2	370.1	26,070.9
Less: allowance for losses	-	(245.2)	-	-	(245.2)
	871.0	19,690.4	4,894.2	370.1	25,825.7
Analysis of credit risk exposure					
Not impaired	871.0	18,908.8	4,894.2	370.1	25,044.1
Impaired	-	1,026.8	-	-	1,026.8
	871.0	19,935.6	4,894.2	370.1	26,070.9
Credit commitments (incl. Derivative and Contingent Liabilities)	-	2,710.2	-	-	2,710.2
Gross credit risk exposure	871.0	22,645.8	4,894.2	370.1	28,781.1
Less: Allowance for losses	-	(245.2)	-	-	(245.2)
Net credit risk exposure	871.0	22,400.6	4,894.2	370.1	28,535.9

2.2 Credit risk management

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

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

2.2.1 Loans and advances to customers

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

The Non-core business continues to carry additional impairment risk. This includes Optimum, a closed book of predominantly interest-only intermediary and acquired residential mortgage book assets. The Non-core business' Legacy Portfolio asset book is also relatively concentrated, with the result that a small number of borrowers account for a large proportion of the total balance outstanding. Any significant future impairment of these borrowers would result in a disproportionate impact on the level of impairment. During 2016, the risk of this occurring reduced due to continued deleverage of the Legacy Portfolio book. This has reduced the overall Non-core balance to £4.1bn as at 31 December 2016 from £5.0bn in 31 December 2015.

The Bank's exposures are predominantly within the UK and so any geographic analysis is only UK based. At 31 December 2016 the amount of overseas exposure is £95.0m (2015: £168.0m), split across Corporate (£61.6m) and Unsecured (£33.4m). This represents 0.4% (2015: 0.7%) of the total credit risk exposure.

Other accounting adjustments include accrued interest, interest fair value adjustments, effective interest rate adjustments and Britannia merger fair valued Lifetime Expected Losses (LEL). The value of the LEL represents a difference in the externally reported level of impairment against the gross impairment calculated by Credit Risk. The LEL is an accounting adjustment and Credit Risk manage these assets on a gross customer balance basis. Only the Optimum LEL adjustment now remains and this continues to reduce in scale with the run off of the book.

Audited

	Core			Non-core		
	Retail banking					
31 December 2016	**Secured**	**Unsecured**	**BaCB**	**Legacy Portfolio**	**Optimum**	**Total**
Analysis of balance in note 16a						
Gross loans and advances	**14,215.1**	**710.0**	**499.0**	**1,532.6**	**2,618.3**	**19,575.0**
Less: allowance for losses	**(3.7)**	**(57.6)**	**(1.0)**	**(47.5)**	**(12.5)**	**(122.3)**
	14,211.4	**652.4**	**498.0**	**1,485.1**	**2,605.8**	**19,452.7**
Analysis of credit risk exposure						
Not impaired	**14,030.4**	**638.6**	**469.6**	**1,396.4**	**2,320.8**	**18,855.8**
Impaired	**184.7**	**71.4**	**29.4**	**136.2**	**297.5**	**719.2**
	14,215.1	**710.0**	**499.0**	**1,532.6**	**2,618.3**	**19,575.0**
Credit commitments (incl. Cont. Liab. & Derivatives)	**459.9**	**1,621.8**	**142.7**	**217.3**	**-**	**2,441.7**
Gross credit risk exposure	**14,675.0**	**2,331.8**	**641.7**	**1,749.9**	**2,618.3**	**22,016.7**
Less: Allowance for losses	**(3.7)**	**(57.6)**	**(1.0)**	**(47.5)**	**(12.5)**	**(122.3)**
Net credit risk exposure	**14,671.3**	**2,274.2**	**640.7**	**1,702.4**	**2,605.8**	**21,894.4**
Reconciliation of accounting to customer balances						
Gross loans and advances	**14,215.1**	**710.0**	**499.0**	**1,532.6**	**2,618.3**	**19,575.0**
Accounting adjustments	**(77.6)**	**(12.9)**	**(36.0)**	**(23.4)**	**17.1**	**(132.8)**
Gross customer balances	**14,137.5**	**697.1**	**463.0**	**1,509.2**	**2,635.4**	**19,442.2**

31 December 2015 (Restated)	Core			Non-core		
	Retail banking					
	Secured	Unsecured	BaCB	Legacy Portfolio	Optimum	Total
Analysis of balance in note 16a						
Gross loans and advances	13,456.5	878.3	549.4	2,176.9	2,874.5	19,935.6
Less: allowance for losses	(3.8)	(100.5)	(1.8)	(125.9)	(13.2)	(245.2)
	13,452.7	777.8	547.6	2,051.0	2,861.3	19,690.4
Analysis of credit risk exposure						
Not impaired	13,261.8	751.5	516.6	1,822.8	2,556.1	18,908.8
Impaired	194.7	126.8	32.8	354.1	318.4	1,026.8
	13,456.5	878.3	549.4	2,176.9	2,874.5	19,935.6
Credit commitments (incl. Cont. Liab. & Derivatives)	514.1	1,810.1	180.2	205.8	-	2,710.2
Gross credit risk exposure	13,970.6	2,688.4	729.6	2,382.7	2,874.5	22,645.8
Less: Allowance for losses	(3.8)	(100.5)	(1.8)	(125.9)	(13.2)	(245.2)
Net credit risk exposure	13,966.8	2,587.9	727.8	2,256.8	2,861.3	22,400.6
Reconciliation of accounting to customer balances						
Gross loans and advances	13,456.5	878.3	549.4	2,176.9	2,874.5	19,935.6
Accounting adjustments	(85.5)	(41.4)	3.1	(24.7)	12.2	(136.3)
Gross customer balances	13,371.0	836.9	552.5	2,152.2	2,886.7	19,799.3

The above table has been restated to show an updated split between not impaired and impaired assets to reflect the inclusion of non-defaulted forborne customers to align to the 2016 reported position. This update has also impacted subsequent tables where the not impaired/impaired split is used.

Secured residential mortgage 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 2016, 12.5% (2015: 12.8%) of mortgages were originated directly and 87.5% (2015: 87.2%) through intermediaries.

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

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

The table below shows residential mortgage completions in the period (including cases where customers have ported their mortgage from one property to another), analysed by loan-to-value (LTV) and repayment method.

Unaudited

	Year to 31 December 2016			Year to 31 December 2015		
	Amount advanced	**Average LTV %**	**Interest only %**	Amount advanced	Average LTV %	Interest only %
Retail prime	**396.9**	**60.2**	**0.7**	357.1	60.8	0.9
Platform prime	**2,347.2**	**69.1**	**-**	1,962.8	73.9	-
Total prime	**2,744.1**	**67.8**	**0.1**	2,319.9	71.5	0.1
Buy-to-let	**439.6**	**65.1**	**91.7**	475.2	67.0	89.6
Total completions (including ports)	**3,183.7**	**67.4**	**12.7**	2,795.1	70.7	15.4

Retail Secured completions increased by 13.9% from 2015 driven predominantly through Platform prime lending.

Risk in the portfolio is recalculated monthly, using internally developed behavioural models. A regional house price index is used to reflect any changes in the value of collateral updated on a quarterly basis. This process is also used to determine the amount of capital which is required to be held for individual loans. The provision rate assigned to new business written in 2016 is 0.04%, reflecting the prime lending and LTV profile.

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

Gross customer balances split by indexed LTV bandings are shown below. The 2015 balances have been re-presented to show part-repayment and part-interest customer as part of the interest only balances:

Audited

	31 December 2016				
	Retail secured		**Optimum**		
LTV %	**Capital Repayment**	**Interest only**	**Capital Repayment**	**Interest only**	**Total**
Less than 50%	**4,773.2**	**1,641.1**	**177.0**	**389.6**	**6,980.9**
50% to 60%	**1,776.5**	**660.4**	**76.3**	**465.8**	**2,979.0**
60% to 70%	**1,923.0**	**599.9**	**70.8**	**475.0**	**3,068.7**
70% to 80%	**1,563.6**	**195.8**	**37.5**	**439.0**	**2,235.9**
80% to 90%	**829.5**	**58.0**	**8.5**	**312.8**	**1,208.8**
90% to 100%	**79.3**	**25.4**	**1.2**	**137.9**	**243.8**
Greater than 100%	**3.1**	**8.7**	**0.7**	**43.3**	**55.8**
	10,948.2	**3,189.3**	**372.0**	**2,263.4**	**16,772.9**

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

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

Unaudited

	31 December 2016					
	< 1 year	**1-5 years**	**5-10 years**	**10-20 years**	**20+ years**	**Total**
Retail Secured	**118.9**	**363.7**	**655.4**	**1,449.8**	**601.5**	**3,189.3**
Optimum	**57.1**	**165.2**	**377.6**	**1,597.4**	**66.1**	**2,263.4**
	176.0	**528.9**	**1,033.0**	**3,047.2**	**667.6**	**5,452.7**

	31 December 2015					
	< 1 year	1-5 years	5-10 years	10-20 years	20+ years	Total
Retail Secured	121.8	402.2	705.4	1,609.6	537.6	3,376.6
Optimum	52.8	142.4	316.4	1,851.9	91.0	2,454.5
	174.6	544.6	1,021.8	3,461.5	628.6	5,831.1

Retail secured interest only balances have reduced by 5.5% during the period, with a shift in LTV distribution largely due to improvements in HPI. Other retail balances have grown, driven by the new completions through Platform. A shift towards the lower risk LTV bands is less pronounced for non-interest only balances due to the increase in higher lending via Platform Prime, most notable in LTV band 80-90%.

The proportion of Total Retail secured balances with current LTV less than 50% has remained stable in the year to 31 December 2016 to 45.4% (2015: 47.8%), driven largely through Capital Repayment balances.

Optimum balances continue to decrease with total balances standing at £2.6bn (2015: £2.9bn), 21.5% of which have a current LTV less than 50% (2015: 15.7%). Interest only includes mortgages on a part-repayment and part-interest only basis.

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

Unaudited

	31 December 2016					
	Retail secured			**Optimum**		
	Gross customer balance	**Average LTV %**	**Interest only %**	**Gross customer balance**	**Average LTV %**	**Interest only %**
Prime residential	**12,802.8**	**50.5**	**15.7**	**172.1**	**66.2**	**84.6**
Buy-to-let	**1,254.3**	**57.2**	**89.8**	**903.7**	**62.0**	**94.8**
Self-certified	**52.7**	**38.3**	**88.2**	**759.7**	**62.2**	**87.2**
Almost prime	**26.5**	**40.9**	**32.7**	**422.6**	**73.2**	**78.2**
Non-conforming	**1.2**	**52.4**	**47.7**	**377.3**	**59.8**	**71.2**
	14,137.5	**51.1**	**22.6**	**2,635.4**	**63.8**	**85.9**

	31 December 2015					
	Retail secured			Optimum		
	Gross customer balance	Average LTV %	Interest only %	Gross customer balance	Average LTV %	Interest only %
Prime residential	12,241.4	49.1	19.6	190.8	70.5	84.1
Buy-to-let	1,034.7	56.9	88.5	984.2	65.1	94.3
Self-certified	61.2	39.9	87.2	830.6	66.3	86.3
Almost prime	32.4	44.4	33.1	464.1	77.8	76.8
Non-conforming	1.3	55.8	47.1	417.0	63.6	70.0
	13,371.0	49.7	25.3	2,886.7	67.6	85.0

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

Audited

	31 December 2016		31 December 2015	
	Retail secured	**Optimum**	Retail secured	Optimum
London & South East	**6,173.4**	**1,182.8**	5,514.3	1,311.7
Northern England	**2,750.8**	**590.4**	2,744.2	633.0
Midlands & East Anglia	**2,866.3**	**423.8**	2,842.1	465.2
Wales & South West	**1,657.6**	**262.3**	1,611.6	285.7
Other	**689.4**	**176.1**	658.8	191.1
Total	**14,137.5**	**2,635.4**	13,371.0	2,886.7

Lending in London and South East has increased in 2016, and accounts for a slightly higher proportion of overall lending at 43.7% (2015: 41.2%).

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 but 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 2016					
	Retail secured			**Optimum**		
	Gross customer balance	**Collateral**	**Cover %**	**Gross customer balance**	**Collateral**	**Cover %**
Impaired	**184.7**	**184.4**	**99.8**	**297.5**	**295.6**	**99.4**
Not Impaired	**13,952.8**	**13,949.9**	**100.0**	**2,337.9**	**2,334.9**	**99.9**
	14,137.5	**14,134.3**	**100.0**	**2,635.4**	**2,630.5**	**99.8**

	31 December 2015					
	Retail secured			Optimum		
	Gross customer balance	Collateral	Cover %	Gross customer balance	Collateral	Cover %
Impaired	194.7	194.1	99.7	318.4	314.9	98.9
Not Impaired	13,176.3	13,165.8	99.9	2,568.3	2,563.1	99.8
	13,371.0	13,359.9	99.9	2,886.7	2,878.0	99.7

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. For the purposes of determining capital and impairment, appropriate forced sale discount assumptions are applied to collateral.

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

The table shown below reports coverage ratios calculated using:

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

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

Audited

	31 December 2016		31 December 2015 (Restated)	
	Retail secured	**Optimum**	Retail secured	Optimum
Gross loans and advances	**14,215.1**	**2,618.3**	13,456.5	2,874.5
of which impaired	**184.7**	**297.5**	194.7	318.4
Impaired as a % of gross loans and advances	**1.3%**	**11.4%**	1.4%	11.1%
Allowance for losses	**3.7**	**12.5**	3.8	13.2
Coverage - impaired assets	**2.0%**	**4.2%**	2.0%	4.1%
Coverage - total book	**0.03%**	**0.48%**	0.03%	0.46%

Retail impaired balances reduced in the period by 5.1%, largely driven by a reduction in arrears. An increase in new Platform lending, coupled with a reduction in total impaired balances leads to the proportion of impaired balances reducing from 1.4% to 1.3%. Impairment provisions remain broadly stable in the period as improvements in HPI and reduction in impairment is offset by growth in the Platform portfolio.

A reduction in arrears balances in the Optimum portfolio has also led to a decrease in impaired balances by 6.6%. However, this decrease when compared to the decline in the overall book drives a small increase in the proportion of impaired loans from 11.1% to 11.4%. A release in impairment provisions in the period is largely driven by improvements in HPI.

Provision impairments as a percentage of gross loans and advances have remained stable in the year, Retail 0.03% (2015: 0.03%) and Optimum 0.48% (2015: 0.46%). The underlying coverage on the impaired assets only has also remained stable in the year, Retail 2.0% (2015: 2.0%) and Optimum 4.2% (2015: 4.1%).

- the Retail 90+ days past due and default balance is £49.2m (2015: £52.3m) 0.3% of total customer balances (2015: 0.4%); and
- the Optimum 90+ days past due and default balance is £139.0m (2015: £152.5m) 5.3% of total customer balances (2015: 5.3%).

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

Audited

	31 December 2016		31 December 2015 (Restated)	
	Retail secured	**Optimum**	Retail secured	Optimum
Balance at start of the year	**194.7**	**318.4**	178.3	957.6
Classified as impaired during the year	**82.6**	**96.2**	98.3	97.1
Transferred to unimpaired during the year	**(57.7)**	**(72.6)**	(53.0)	(99.6)
Net repayments and other	**(34.9)**	**(44.5)**	(28.9)	(636.7)
Balance at the end of the year	**184.7**	**297.5**	194.7	318.4

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

Unaudited

	31 December 2016			31 December 2015		
	Retail secured	**Optimum**	**Total**	Retail secured	Optimum	Total
Low to medium risk	**13,596.4**	**1,841.0**	**15,437.4**	12,877.2	1,998.6	14,875.8
Medium to high risk	**356.4**	**496.9**	**853.3**	299.1	569.7	868.8
	13,952.8	**2,337.9**	**16,290.7**	13,176.3	2,568.3	15,744.6

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 CRD IV. An increase in medium to high risk unimpaired exposures is largely driven by the increase in higher LTV lending in the Platform portfolio within the Retail Secured book.

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

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

Forbearance

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

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

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

Unaudited

	31 December 2016				31 December 2015 (Restated)			
Retail secured	Non arrears	In arrears or defaulted	Total	Impairment coverage	Non arrears	In arrears or defaulted	Total	Impairment coverage
Concessions	2.4	5.4	7.8	0.1	3.0	4.8	7.8	-
Arrangements	6.4	13.5	19.9	0.2	7.5	13.7	21.2	0.2
Term extensions	17.3	0.2	17.5	-	32.3	-	32.3	-
Assisted Voluntary Sale	-	0.1	0.1	-	-	0.1	0.1	-
Interest only switches	1.5	0.7	2.2	-	0.6	-	0.6	-
Capitalisations	0.1	-	0.1	-	-	-	-	-
Term expired	51.4	4.2	55.6	0.2	46.5	3.4	49.9	0.2
Payment Holiday	11.1	1.3	12.4	-	-	-		-
Deceased Grace Period	0.7	0.7	1.4	-	-	-	-	-
	90.9	26.1	117.0	0.5	89.9	22.0	111.9	0.4

	31 December 2016				31 December 2015 (Restated)			
Optimum	Non arrears	In arrears or defaulted	Total	Impairment coverage	Non arrears	In arrears or defaulted	Total	Impairment coverage
Concessions	1.2	5.9	7.1	0.1	2.8	5.5	8.3	0.2
Arrangements	17.0	77.2	94.2	4.7	18.3	71.6	89.9	4.4
Term extensions	0.6	0.1	0.7	-	0.8	-	0.8	-
Assisted Voluntary Sale	-	-	-	-	-	-	-	-
Interest only switches	0.2	0.6	0.8	-	-	-	-	-
Capitalisations	0.2	-	0.2	-	-	-	-	-
Term expired	29.4	5.7	35.1	1.6	18.9	2.7	21.6	0.8
Payment Holiday	2.1	0.3	2.4	-	-	-	-	-
Deceased Grace Period	2.0	0.1	2.1	-	-	-	-	-
	52.7	89.9	142.6	6.4	40.8	79.8	120.6	5.4

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

Retail forbearance balances have increased by £5.1m (4.6%) since 31 December 2015 primarily due to term expired balances being higher and the addition of finance payment holidays.

Optimum forbearance balances have increased by £22.0m (18.2%) since 31 December 2015 primarily due to term expired balances being £13.5m higher.

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

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:

Unaudited

	31 December 2016	31 December 2015
Loans	**180.6**	288.0
Professional and career development loans	**65.0**	79.3
Credit cards	**1,790.6**	1,981.8
Overdrafts	**282.7**	297.9
	2,318.9	2,647.0

Total unsecured balances, including undrawn commitments have reduced by 12.4% during the period. Loan balances have reduced by 37.3% due to asset amortisation, low volumes of new business and a debt sale of £45.0m of impaired loans during 2016. Credit card exposure has reduced by 9.6% driven primarily by customer Management Limit strategies along with a reduction in customer balances.

Impairment

An impairment provision is recognised for the following categories:

- identified impairment – at 'one penny, one day past due', forborne or in excess, based on the probability of default and the discounted cash flow of recoveries from default; and
- unidentified impairment – on the performing book, based on the probability of the emergence of delinquencies, the probability of default and the discounted cash flow of recoveries from default.

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

Audited

	31 December 2016	31 December 2015
Gross loans and advances	**710.0**	878.3
of which impaired	**71.4**	126.8
Impaired as a % of gross loans and advances	**10.1%**	14.4%
Allowance for losses	**57.6**	100.5
Coverage – impaired assets	**80.7%**	79.3%
Coverage – total book	**8.11%**	11.44%

A reduction of £168.3m (19.2%) in gross loans and advances in the year to 31 December 2016 is driven by asset amortisation, low volumes of new business across all portfolios and a debt sale of £45.0m of impaired loans. The proportion of impaired loans has reduced from 14.4% to 10.1% driven largely by the loan debt sale. Coverage, reported as allowance for losses as a percentage of impaired balances, has remained broadly stable at 80.7%, however, allowance for losses as a percentage of gross loans and advances has reduced from 11.4% to 8.1% due following the sale of impaired loans.

Corporate credit risk

Acquisition and account management
The Bank operates lending criteria that requires borrowers to meet criteria as laid down in individual sector strategy guidelines and strict policy with regards to single name and sector concentrations. Currently the Bank has a very limited appetite for new corporate lending.

Non-core Legacy Portfolio lending decisions over £250k are made by the Strategic Asset Review (SAR) group. SAR lending comprises of first and second line business and credit risk representatives where the majority of decisions are taken to set run-off or exit strategies.

Monitoring of portfolios and impairment provisioning governance is in place across the portfolios.

BaCB
The majority of BaCB rated customers are rated as strong or good (69.2%), with 25.1% rated via the standardised approach. The BaCB portfolio represents a number of industry sectors with largest concentrations evident in Property and Construction (27.4%), Retail and Wholesale (13.1%) plus Services (11.0%) and Financial Services (10.7%)

The tables below show the distribution of the BaCB customer balances (including commitments) by sector and risk grade, where PD grades have been mapped to regulatory slotting categories.

Unaudited

31 December 2016	**Standardised**	**Strong**	**Good**	**Satisfactory**	**Weak**	**Default**	**Total**
BaCB							
Financial Services	**16.4**	**36.9**	**10.8**	**0.5**	**-**	**-**	**64.6**
Property and Construction	**29.2**	**3.8**	**126.7**	**4.7**	**-**	**1.3**	**165.7**
Retail and wholesale trade	**0.6**	**73.9**	**0.4**	**4.4**	**-**	**-**	**79.3**
Services	**43.2**	**16.0**	**5.3**	**2.3**	**-**	**-**	**66.8**
Business banking	**0.5**	**19.0**	**23.2**	**5.7**	**0.5**	**0.2**	**49.1**
Other	**62.4**	**69.9**	**33.5**	**11.9**	**1.2**	**1.3**	**180.2**
Total BaCB	**152.3**	**219.5**	**199.9**	**29.5**	**1.7**	**2.8**	**605.7**

31 December 2015	Standardised	Strong	Good	Satisfactory	Weak	Default	Total
BaCB							
Financial Services	15.7	32.8	12.3	0.2	1.4	0.1	62.5
Property and Construction	19.3	2.4	156.6	12.4	1.5	2.2	194.4
Retail and wholesale trade	1.3	91.1	0.5	6.0	–	–	98.9
Services	62.4	11.7	18.6	2.4	0.1	0.5	95.7
Business banking	–	20.8	20.1	5.0	0.8	0.3	47.0
Other	83.7	97.3	37.3	11.7	-	4.2	234.2
Total BaCB	182.4	256.1	245.4	37.7	3.8	7.3	732.7

Legacy Portfolio
The Legacy Portfolio represents 74.0% of gross corporate customer balances and commitments, with 83.8% of the corporate Legacy 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 33.9% and 38.6% of total Legacy Portfolio balances. During 2016 Legacy Portfolio reduced its exposure to Property and Construction to 15.4% from 24.7% in 2015.

The reduction in Legacy Portfolio exposures during 2016 reflects the continued deleveraging in line with the Bank's risk appetite. It is most evident in Property and Construction, PFI, Renewable Energy and Housing Associations sectors. Within the Property and Construction sector Commercial Property Investment has seen the most significant reduction in exposures in the default category.

The tables below show the distribution of the Legacy Portfolio balances (including commitments) by sector and risk grade, where PD grades have been mapped to regulatory slotting categories.

Unaudited

31 December 2016	Standardised	Strong	Good	Satisfactory	Weak	Default	Total
Legacy Portfolio							
Housing associations	**4.2**	**580.9**	**-**	**-**	**-**	**-**	**585.1**
PFI	**-**	**287.8**	**379.0**	**0.1**	**-**	**-**	**666.9**
Property and Construction	**9.8**	**-**	**142.4**	**18.4**	**11.7**	**83.7**	**266.0**
Renewable energy	**80.1**	**-**	**-**	**-**	**-**	**9.0**	**89.1**
Other	**33.3**	**50.8**	**5.1**	**5.9**	**-**	**24.3**	**119.4**
Total Legacy Portfolio	**127.4**	**919.5**	**526.5**	**24.4**	**11.7**	**117.0**	**1,726.5**
Total BaCB and Legacy Portfolio	**279.7**	**1,139.0**	**726.4**	**53.9**	**13.4**	**119.8**	**2,332.2**

31 December 2015	Standardised	Strong	Good	Satisfactory	Weak	Default	Total
Legacy Portfolio							
Housing associations	4.5	685.0	–	–	–	0.3	689.8
PFI	–	47.1	641.7	–	–	18.4	707.2
Property and Construction	12.4	24.0	225.9	63.3	54.2	202.4	582.2
Renewable energy	123.3	–	–	–	–	0.1	123.4
Other	66.4	72.1	11.9	19.8	2.6	82.6	255.4
Total Legacy Portfolio	206.6	828.2	879.5	83.1	56.8	303.8	2,358.0
Total BaCB and Legacy Portfolio	389.0	1,084.3	1,124.9	120.8	60.6	311.1	3,090.7

Collateral

The Bank uses various forms of collateral, including guarantees, to mitigate credit risk. Property collateral for corporate lending is categorised as security for property development investment customers (i.e. '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, cash cover and guarantees (often supported by tangible security where appropriate, including property, life policies and stocks and shares).

Property valuations are obtained when the facility is first approved and our lending procedures typically require collateral to be revalued every 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.

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

Audited

	31 December 2016			31 December 2015		
	Exposure	**Collateral[1]**	**Impairment provision**	Exposure	Collateral[1]	Impairment provision
BaCB						
Non-default loans with ≤1 year until refinancing and all defaulted exposures regardless of term						
Less than 50%	**28.9**	**28.9**	**-**	27.9	27.9	-
50% to 80%	**12.7**	**12.6**	**-**	4.8	4.8	-
80% to 100%	**5.3**	**5.2**	**0.1**	-	-	-
Greater than 100%	**-**	**-**	**-**	0.3	0.1	0.1
Unsecured	**39.5**	**-**	**0.5**	38.9	-	1.0
	86.4	**46.7**	**0.6**	71.9	32.8	1.1
Non-default loans with >1 year until refinancing and all non-loan non-defaulted exposures regardless of term						
Less than 50%	**146.3**	**146.3**	**-**	230.6	230.6	-
50% to 80%	**142.2**	**142.2**	**-**	163.2	163.1	-
80% to 100%	**20.0**	**20.0**	**0.1**	12.8	12.8	-
Greater than 100%	**11.1**	**6.1**	**-**	20.2	12.8	0.1
Unsecured	**199.7**	**-**	**0.3**	234.0	-	0.6
	519.3	**314.6**	**0.4**	660.8	419.3	0.7
Total BaCB	**605.7**	**361.3**	**1.0**	732.7	452.1	1.8

Audited

	31 December 2016			31 December 2015		
	Exposure	**Collateral[1]**	**Impairment provision**	Exposure	Collateral[1]	Impairment provision
Legacy Portfolio						
Non-default loans with ≤1 year until refinancing and all defaulted exposures regardless of term						
Less than 50%	**35.5**	**35.4**	**0.1**	34.6	34.3	0.3
50% to 80%	**52.6**	**52.6**	**-**	141.3	132.4	8.9
80% to 100%	**2.0**	**1.7**	**0.3**	85.2	55.1	29.9
Greater than 100%	**44.6**	**17.4**	**26.5**	126.1	70.2	51.9
Unsecured	**36.7**	**-**	**19.0**	50.0	-	31.1
	171.4	**107.1**	**45.9**	437.2	292.0	122.1
Non-default loans with >1 year until refinancing and all non-loan non-defaulted exposures regardless of term						
Less than 50%	**334.2**	**334.2**	**-**	312.8	312.8	-
50% to 80%	**473.5**	**473.5**	**-**	752.3	752.3	0.1
80% to 100%	**52.7**	**52.7**	**-**	77.9	77.8	0.2
Greater than 100%	**73.5**	**34.7**	**-**	62.1	27.3	0.1
Unsecured	**621.2**	**-**	**1.6**	715.7	-	3.4
	1,551.1	**895.1**	**1.6**	1,920.8	1,170.2	3.8
Total Legacy Portfolio	**1,726.5**	**1,002.2**	**47.5**	2,358.0	1,462.2	125.9

1. Collateral is constrained to a maximum of 100% of the exposure to each customer to correctly reflect the maximum protection available to the Bank. For the purposes of determining capital and impairment appropriate forced sale discounts are applied to collateral. As at 31 December 2016 £2.9m (2015: £6.3m) of the collateral is not held as first charge.

The overall Corporate portfolio in the year to 31 December 2016 has seen a reduction in impaired exposures (from £386.9m in 2015 to £165.6m in 2016) and specific and general credit risk adjustments (from £127.7m in 2015 to £48.5m in 2016), most notably for Commercial Investments within the Property and Construction sector (£67.2m reduction in default exposures). This is reflective of the Bank's strategy to deleverage Non-core assets.

Impairment

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

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

The Bank also reviews high risk loans (including those accounts subject to forbearance) on a monthly basis through the Corporate Impairment and Default Group (and quarterly through the Impairment Charge Forum), and considers the potential loss which may arise were the borrowers to fail (notwithstanding that continued trading remains the expectation). A collective unidentified impairment provision (CUIP) provides for the non-defaulted portfolio.

Corporate customers may be treated as impaired when one or more defined impairment trigger events are evident. Provisioning adjustments are also recorded, as appropriate, against loans whose interest terms have changed such that revised future cash flows discounted at the original effective interest rate are less than the current carrying amount.

Audited

	31 December 2016		31 December 2015	
	BaCB	**Legacy Portfolio**	BaCB	Legacy Portfolio
Gross loans and advances	**499.0**	**1,532.6**	549.4	2,176.9
of which impaired	**29.4**	**136.2**	32.8	354.1
Impaired as a % of gross loans and advances	**5.9%**	**8.9%**	6.0%	16.3%
Allowance for losses	**1.0**	**47.5**	1.8	125.9
Coverage – impaired assets	**3.4%**	**34.9%**	5.5%	35.6%
Coverage – total book	**0.20%**	**3.10%**	0.33%	5.78%

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

BaCB gross loans and advances have fallen over the period reflecting a mix of cases that have rebanked and maturities/amortisations that have not been replaced with new advances. Impaired balances as a percentage of total balances have remained static during 2016.

Following the trend of prior years, Legacy Portfolio gross loans and advances have significantly decreased over the year reflecting the deleverage activity from sales, rebanking and non performing work outs. The mix of deleverage activity has led to a reduction in the impaired percentage from 16.3% to 8.9%. This has also led to a reduction in the allowance for losses.

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

Audited

	31 December 2016		31 December 2015	
	BaCB	**Legacy Portfolio**	BaCB	Legacy Portfolio
Balance at start of year	**32.8**	**354.1**	26.7	1,216.0
Classified as impaired during the year	**21.9**	**115.9**	27.9	118.0
Transferred to unimpaired during year	**(12.0)**	**(19.8)**	(8.0)	(111.1)
Amounts written off	**(0.5)**	**(91.6)**	-	(363.1)
Net repayments and other	**(12.8)**	**(222.4)**	(13.8)	(505.7)
Balance at the end of the year	**29.4**	**136.2**	32.8	354.1

Forbearance

The identification of financial difficulty is a key part of the process of deploying forbearance. 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.

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

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

The table below analyses the exposures subject to forbearance:

Unaudited

	31 December 2016			31 December 2015		
	Forborne	**Non-forborne**	**Total**	Forborne	Non-forborne	Total
BaCB						
Default	**-**	**2.8**	**2.8**	-	7.2	7.2
On watch list	**11.8**	**17.9**	**29.7**	3.7	24.9	28.6
Neither default nor on watch list	**-**	**573.2**	**573.2**	1.4	695.5	696.9
Total BaCB	**11.8**	**593.9**	**605.7**	5.1	727.6	732.7
Legacy Portfolio						
Default	**22.3**	**94.7**	**117.0**	102.4	201.5	303.9
On watch list	**0.7**	**22.7**	**23.4**	31.1	33.2	64.3
Neither default nor on watch list	**-**	**1,586.1**	**1,586.1**	11.8	1,978.0	1,989.8
Total Legacy Portfolio	**23.0**	**1,703.5**	**1,726.5**	145.3	2,212.7	2,358.0
Total BaCB and Legacy Portfolio	**34.8**	**2,297.4**	**2,332.2**	150.4	2,940.3	3,090.7

Overall forborne exposure has reduced as overall exposure reduces. The increase in BaCB reflects a change in policy whereby customers classified as forborne remain under this category rather than being moved to the Legacy Portfolio balance sheet.

2.2.2 Investment securities

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

Audited

		Investment securities		
31 December 2016	**Loans & receivables**	**Available for sale**	**Fair value through profit or loss**	**Total**
Analysis of balance in note 17				
Gross Balance	**13.8**	**3,538.1**	**-**	**3,551.9**

		Investment securities		
31 December 2015	Loans & receivables	Available for sale	Fair value through profit or loss	Total
Analysis of balance in note 17				
Gross Balance	15.0	4,296.8	582.4	4,894.2

No allowance for losses has been recognised for investment securities in either 2016 or 2015. All are classified as low to medium risk.

Collateral

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

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 have an external credit rating agency equivalent to Fitch A or above resulting in the investment security portfolio having 100% (2015: 100%) of such ratings.

2.2.3 Loans and advances to banks

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

2.2.4 Derivative financial instruments

During 2016 the Bank continued to clear all new derivative transactions through a central clearing counterparty. The Bank also sought agreement from a number of counterparties to re-book existing derivative transactions through its central clearing counterparty. In accordance with IFRS 13, a credit value adjustment (CVA) of £1.1m was recorded (31 December 2015: £3.2m); the reduction being mainly due to a lower spread being applied to the PFI book.

Audited

	31 December 2016		31 December 2015	
	Derivative notional	**Derivative fair value (net)**	Derivative notional	Derivative fair value (net)
Interest rate				
Bi-lateral collateral agreements	**12,670.3**	**(324.8)**	14,351.0	(266.5)
One way collateral	**1,295.7**	**30.8**	2,088.5	11.4
No collateral agreement	**517.6**	**152.4**	681.2	121.3
Foreign exchange				
Bi-lateral collateral agreements	**2.4**	**(0.5)**	110.0	1.6
One way collateral	**293.2**	**123.3**	1,058.4	158.2
No collateral agreement	**81.7**	**(0.2)**	68.3	(1.9)
	14,860.9	**(19.0)**	18,357.4	24.1

The above table has been re-presented in order to separately identify one way collateral agreements. Further disclosures on derivatives are contained in note 18.

2.2.5 Wholesale credit risk

The Bank's Treasury portfolio is held primarily for liquidity management purposes and, in the case of derivatives, for the purpose of managing market risk. Exposures to the UK government and Bank of England account for 60% (2015: 54%) of all Treasury exposures. The remaining exposures are split 19% (2015: 21%) to mortgage backed securities, 13% (2015: 15%) to financial institutions and 8% (2015: 10%) non-domestic sovereign and qualifying multi-lateral development bank bonds.

2.2.5.1 Direct exposures

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

Treasury operates a risk based approach which monitors counterparty limits and exposure 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 monitors the portfolio and watchlists daily for appropriate risk status bandings and any associated management actions. As at 31 December 2016 there were no red (highest risk) exposures outstanding (2015: £nil).

During 2016, exposures to financial institutions in European countries were broadly consistent with the year end with a total gross exposure outstanding at 31 December 2016 of £47.0m (2015: £194.0m). Post credit risk mitigation the net exposure was £47.0m (2015: £194.0m).

2.2.5.2 Indirect exposures

The Bank's Treasury 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's secondary exposure, the Bank assesses 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.

3. Liquidity and funding Risk

3.1 Overview

The Board determines the level of liquid resources required to support the Bank's business objectives through the risk appetite and undertaking an Internal Liquidity Adequacy Assessment Process (ILAAP). This process reviews the liquidity risk management framework, assesses the qualitative and quantitative liquidity and funding risks to which the Bank is exposed including under stressed conditions evaluates the liquidity and funding requirements of the Bank's financial projections and concludes on the adequacy of its liquid resources.

The ILAAP and compliance with the Overall Liquidity Adequacy Rule (OLAR) is reviewed and approved by the Board and is reviewed by the PRA as part of the Liquidity Supervisory Review and Evaluation Process (L-SREP). Following the L-SREP, the PRA issues Individual Liquidity Guidance (ILG) which determines the amount of liquidity which is required to be held in Pillar 2. On 1 October 2015 the LCR became the primary regulatory standard for liquidity and ILG is set with reference to liquidity coverage ratio (LCR). LCR is being introduced on a phased basis and UK banks are initially required to maintain a minimum of 80% of LCR, rising to 90% on 1 January 2017 and 100% in 2018.

To manage its liquidity and funding risk the Bank monitors the following:

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

The Bank has an established funding base, predominantly comprising retail and commercial deposits. The Bank closely monitors and manages its liquidity position, maintaining a regulatory liquidity buffer appropriate for the Bank's funding profile in order to ensure the Bank meets its financial obligations as and when they fall due. In a more severe stress, the Bank would in the first instance invoke its own Contingency Funding Plan (CFP). The Bank can then invoke its Recovery Plan, maintained under UK regulatory rules implementing the European Bank Recovery and Resolution Directive (BRRD), which documents a number of potential management actions.

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

- liquidity coverage ratio (LCR), 213.5% (2015: 245.8%) which represents a surplus to regulatory requirements. The strong liquidity position aligns to the Bank's risk strategy to maintain a prudent liquidity position, although the surplus to regulatory requirements may vary due to cash flow mismatches and fluctuations in the Bank's funding profile over time;

- internal liquidity stress tests – the survival period of the Bank under an applicable stress scenario. The Bank held a buffer in excess of the requirements from the applicable stress scenario at 31 December 2016;

- customer loan/deposit ratio, 86.7% (2015: 86.3%) – the ratio of customer loans (excluding credit commitments) to customer deposits; and

- encumbrance ratio, 17.8% (2015: 21.8%) – per the EBA definition, asset encumbrance ratio = (carrying amount of encumbered assets and collateral)/(total assets and collateral). An asset is considered as encumbered if it has been pledged or if it is subject to any form of arrangement to secure, collateralise or credit enhance any transaction from which it cannot be freely withdrawn.

3.3 Liquid asset portfolios - Unaudited
Total liquidity resources as at 31 December 2016 were £8,240.3m (2015: £10,247.1m). The Bank is focused on maintaining a high percentage of liquid assets which are high-quality and the table below analyses the Bank's liquidity portfolio by product and unencumbered liquidity value. The Bank categorises its liquidity portfolio into primary and secondary (other liquid assets and contingent liquidity).

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

Secondary liquidity comprises of unencumbered liquid investment securities not included as part of primary liquidity as well as other forms of contingent liquidity sources. In the 2015 Annual Report and Accounts contingent liquidity included all other non-primary liquid assets. The Bank has now narrowed the contingent liquidity definition in the statutory accounts to only include unencumbered assets (excluding liquid investments securities) available for use at the Central Bank and therefore the 2015 comparatives have been restated to align with this change. The reduction in secondary liquidity in 2016 reflects a combination of amortisation of assets, sale and management of secured funding collateral requirements to support the Bank's funding profile and collateralisation of the Britannia pension scheme.

	31 December 2016	31 December 2015 (Restated)
Operational balances with central banks	**2,571.4**	2,329.3
Gilts	**676.2**	1,450.2
Central government and multilateral development bank bonds	**568.5**	760.2
Total primary liquid assets	**3,816.1**	4,539.7
Other liquid assets	**727.2**	1,386.6
Contingent liquidity	**3,697.0**	4,320.8
Total liquidity	**8,240.3**	10,247.1
Average balance	**9,061.2**	11,107.5

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

Included within the primary liquid asset balance above is £178.0m (2015:Nil) of UK government gilts obtained through a collateral upgrade transaction. In accordance within the recognition criteria for financial assets under IAS 39, these gilts are not recognised on the Bank's balance sheet.

3.3.1 Wholesale funding - Unaudited

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

	31 December 2016	31 December 2015
Preference shares and subordinated debt	**456.0**	457.0
Secured funding	**1,197.6**	2,091.0
Repos	**990.6**	671.3
Market borrowing	**4.1**	10.9
MTNs	**405.4**	404.9
Total wholesale funding	**3,053.7**	3,635.1

The reduction in wholesale funding primarily reflects the repayment of secured funding in the period. Gilt repos make up £833.2m of total repo funding.

The following table sets out the Bank's contractual wholesale funding by maturity, with the maturity of securitisations based on call dates:

	31 December 2016	31 December 2015
Repayable in less than 1 month	**837.4**	522.5
Repayable between 1 and 3 months	**-**	159.7
Repayable between 3 and 6 months	**528.9**	352.4
Repayable between 6 and 9 months	**405.4**	243.3
Repayable between 9 and 12 months	**67.9**	433.0
Repayable between 1 and 2 years	**-**	746.9
Repayable between 2 and 5 years	**1,008.1**	259.0
Repayable in more than 5 years	**206.0**	918.3
Total external funding	**3,053.7**	3,635.1

The above funding can be found within the Deposits by banks, Debt securities in issue and Other borrowed funds lines.

3.4 Liquidity Gap – Audited

Details of contractual maturities for assets and liabilities underpin the management of liquidity risk, however, management recognises that customer behaviour differs to contractual maturity, therefore as part of the planning process, behavioural run-off of customer assets and liabilities over time are estimated. The assumptions used to create these estimates and the estimates themselves are recommended for approval by ALCO as part of its responsibility to manage the Bank's financial plans.

Gross cash flows include interest and other revenue cash flows. Other assets and liabilities include non-financial items and these are excluded from the maturity analysis. The following table is an analysis of gross undiscounted contractual cash flows of financial assets and liabilities held at the balance sheet date:

31 December 2016 Contractual cash flows	Carrying value	Gross nominal flow	Less than 1 month	1-3 months	3-6 months	6-9 months	9-12 months	1-2 years	2-5 years	Over 5 years
Assets										
Cash and balances at central banks	**2,848.2**	**2,848.2**	**2,848.2**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Loans and advances to banks	**836.9**	**837.2**	**461.8**	**196.7**	**178.7**	**-**	**-**	**-**	**-**	**-**
Loans and advances to customers (incl. FVAHR)	**19,584.3**	**27,809.0**	**690.4**	**237.4**	**381.6**	**390.9**	**387.9**	**1,497.5**	**4,116.9**	**20,106.4**
Investment securities										
Loans and receivables	**13.8**	**16.1**	**-**	**-**	**-**	**-**	**-**	**0.1**	**0.3**	**15.7**
Available for sale	**3,538.1**	**3,691.1**	**7.1**	**65.1**	**17.9**	**42.7**	**18.7**	**406.3**	**2,067.1**	**1,066.2**
Fair value through profit or loss	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Derivative financial instruments	**425.5**	**641.3**	**6.6**	**12.3**	**142.0**	**19.1**	**16.6**	**61.0**	**154.5**	**229.2**
Other assets	**341.5**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Total recognised assets	**27,588.3**	**35,842.9**	**4,014.1**	**511.5**	**720.2**	**452.7**	**423.2**	**1,964.9**	**6,338.8**	**21,417.5**
Liabilities										
Deposits by banks	**1,198.6**	**1,175.6**	**837.8**	**0.8**	**268.7**	**0.2**	**68.1**	**-**	**-**	**-**
Customer accounts	**22,425.1**	**22,524.5**	**16,430.7**	**302.2**	**1,119.4**	**1,318.0**	**1,053.2**	**1,482.5**	**818.5**	**-**
Customer accounts – capital bonds	**11.8**	**9.3**	**-**	**2.4**	**3.2**	**2.7**	**1.0**	**-**	**-**	**-**
Debt securities in issue	**1,625.4**	**1,847.7**	**45.7**	**16.9**	**479.0**	**415.6**	**14.8**	**43.6**	**832.1**	**-**
Derivative financial instruments	**444.5**	**716.8**	**10.4**	**19.6**	**29.7**	**26.4**	**26.4**	**87.4**	**181.1**	**335.8**
Other borrowed funds	**472.6**	**699.7**	**3.6**	**7.8**	**10.9**	**21.8**	**10.9**	**44.0**	**350.0**	**250.7**
Other liabilities	**451.8**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Total recognised liabilities	**26,629.8**	**26,973.6**	**17,328.2**	**349.7**	**1,910.9**	**1,784.7**	**1,174.4**	**1,657.5**	**2,181.7**	**586.5**
Unrecognised loan commitments	**2,441.7**	**2,441.7**	**2,106.9**	**334.8**	**-**	**-**	**-**	**-**	**-**	**-**
Total liabilities	**29,071.5**	**29,415.3**	**19,435.1**	**684.5**	**1,910.9**	**1,784.7**	**1,174.4**	**1,657.5**	**2,181.7**	**586.5**

31 December 2015 Contractual cash flows	Carrying value	Gross nominal flow	Less than 1 month	1-3 months	3-6 months	6-9 months	9-12 months	1-2 years	2-5 years	Over 5 years
Assets										
Cash and balances at central banks	2,678.5	2,678.5	2,678.5	-	-	-	-	-	-	-
Loans and advances to banks	871.0	871.0	520.0	351.0	-	-	-	-	-	-
Loans and advances to customers (incl. FVAHR)	19,784.4	31,203.9	602.2	311.5	398.6	395.3	442.7	1,636.7	4,854.8	22,562.1
Investment securities										
Loans and receivables	15.0	18.4	-	-	-	-	-	0.2	0.5	17.7
Available for sale	4,296.8	5,515.2	9.1	233.0	24.7	159.7	21.8	253.0	1,140.1	3,673.8
Fair value through profit or loss	582.4	590.0	3.3	1.3	1.9	2.0	30.7	11.2	515.6	24.0
Derivative financial instruments	370.1	666.7	8.1	11.0	40.3	14.7	79.1	123.3	137.1	253.1
Other assets	430.1	-	-	-	-	-	-	-	-	-
Total recognised assets	29,028.3	41,543.7	3,821.2	907.8	465.5	571.7	574.3	2,024.4	6,648.1	26,530.7
Liabilities										
Deposits by banks	725.9	725.9	566.2	159.7	-	-	-	-	-	-
Customer accounts	22,732.0	22,836.6	15,938.3	1,473.6	975.4	1,644.4	870.2	1,322.4	448.0	164.3
Customer accounts – capital bonds	77.4	59.1	-	13.2	17.0	9.5	10.1	9.3	-	-
Debt securities in issue	2,554.3	2,866.3	10.4	18.6	385.1	262.2	473.1	827.6	129.4	759.9
Derivative financial instruments	346.9	766.1	9.8	19.1	29.1	29.0	26.9	94.9	192.1	365.2
Other borrowed funds	459.9	743.9	3.6	7.8	10.9	21.8	10.9	44.0	371.3	273.6
Other liabilities	768.6	-	-	-	-	-	-	-	-	-
Total recognised liabilities	27,665.0	27,997.9	16,528.3	1,692.0	1,417.5	1,966.9	1,391.2	2,298.2	1,140.8	1,563.0
Unrecognised loan commitments	2,710.2	2,710.2	2,375.4	334.8	-	-	-	-	-	-
Total liabilities	30,375.2	30,708.1	18,903.7	2,026.8	1,417.5	1,966.9	1,391.2	2,298.2	1,140.8	1,563.0

The principle difference between the gross nominal value and the accounting carrying value set out above is due to discounting. Discounting has a greater impact on cash flows in later years, and a minimal impact on cash flows within 1 year. Therefore the contractual cash flows on assets and liabilities expected in less than one year are a fair representation of the contractual maturity of current assets and liabilities at carrying value in the Balance Sheet.

3.5 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 secured funding, to satisfy collateral needs or to be sold to reduce the funding requirement. The encumbrance table is presented based on median values of the last four quarters and therefore will not correspond to the balance sheet asset total which is presented on a point-in-time basis.

	Encumbered Assets					
2016	**As a result of covered bonds**	**As a result of securitisations**	**Other**	**Total**	**Unencumbered Assets**	**Total**
Equity investments	**-**	**-**	**-**	**-**	**45.8**	**45.8**
Debt securities	**-**	**425.9**	**1,079.2**	**1,505.1**	**2,147.4**	**3,652.5**
Other assets	**1,217.9**	**1,120.1**	**1,135.0**	**3,473.0**	**20,779.4**	**24,252.4**
Assets of the reporting institution	**1,217.9**	**1,546.0**	**2,214.2**	**4,978.1**	**22,972.6**	**27,950.7**

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

4. Market Risk

4.1 Overview - Unaudited

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

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

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

The main measure utilised in Market Risk is Present Value of 01 (PV01). The PV01 is the daily calculation of the effect on the Net Present Value (NPV) of Treasury portfolios to both parallel and specific point of yield curve stress testing (i.e. non-linear yield curve shifts) by one basis point. Analysis includes daily parallel shifts in yield curve rates of +/- 100bps with the resultant change in NPVs representing the potential change in portfolio values.

Market risk exposures have been maintained well within the Bank’s risk appetite which has remained unchanged from the end of 2015, as do the primary drivers of market risk. Interest rate risk when expressed in terms of PV01 averaged £62.0k during the year of 2016 with a low of £(5.0k) and a high of £178.0k. A reduction in both the holding and duration of sovereign bond exposures has contributed to a reduction in swap spread risk which has fallen to a PV01 of £(892.0k) (31 December 2015: £(1,043.0k)). There has also been a similar reduction in the Bank’s other credit spread exposures which primarily reflect holdings in Warwick Finance One and Warwick Finance Two securitisations. A combination of repayments and an outright sale has seen the notional holding of mortgage backed securities (MBS) fall from £1,614.0m at 31 December 2015 to £1,318.0m at 31 December 2016.

4.2 Primary risk metrics and sources of market risk - Unaudited

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.

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

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

Similar assumptions are made for other non-interest bearing balance sheet items such as non-dated capital all of which are reviewed and approved by the Bank’s ALCO on a semi-annual basis.

In addition to the balance sheet items noted above interest rate risk is primarily driven by the Bank’s holding of fixed rate assets within its liquidity asset buffer, the sale of fixed rate mortgages and savings products to its customer base and the degree to which these are hedged using the derivative instruments.

Risk exposures are formally calculated at least monthly. Interest rate risk and effectiveness of hedging is monitored at a minimum weekly using gap positions, incorporating new business requirements. Draw down risk, in particular for fixed rate mortgages, is managed through weekly tranche meetings. Treasury 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 in the Bank's balance sheet is mainly driven by a mix of exposures to LIBOR, base rate and administered rate. LIBOR exposures are created through the Bank's holdings of LIBOR linked assets such as MBS and as a result of hedging fixed rate retail products and fixed rate sovereign debt. Reserve balances at the Bank of England and tracker mortgages generate a base rate asset with administered rate exposures generated by mortgages and savings products.

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

Basis risk is monitored by LMRF and ALCO monthly with action taken as required.

Sovereign 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 an organisation is exposed to. These assets are used for liquidity purposes within the Treasury portfolio.

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 primarily limited to customer hedging transactions and incidental customer transactions. Therefore, to manage this risk an overall maximum notional net sterling position limit is set for both intra-day and overnight exposures. This is supported by applying sub-limits to currencies by tier to reflect their liquidity.

Where the Bank has originated non-sterling debt securities or short term borrowings both currency and interest rate risk is mitigated using off setting assets or derivative instruments such as cross currency swaps.

The table below is an analysis of the Bank's assets and liabilities by currency in sterling equivalent terms.

Audited	**31 December 2016**					31 December 2015				
	£	**$**	**€**	**Other**	**Total**	£	$	€	Other	Total
Assets										
Cash and balances at central bank	**2,848.2**	**-**	**-**	**-**	**2,848.2**	2,678.5	-	-	-	2,678.5
Loans and advances to banks	**799.3**	**20.5**	**15.9**	**1.2**	**836.9**	805.8	34.4	29.6	1.2	871.0
Loans and advances to customers	**19,404.8**	**30.5**	**17.3**	**0.1**	**19,452.7**	19,643.7	27.1	19.5	0.1	19,690.4
Fair Value adjustments for hedged risk	**131.6**	**-**	**-**	**-**	**131.6**	94.0	-	-	-	94.0
Investment securities										
Loans and receivables	**11.0**	**1.8**	**1.0**	**-**	**13.8**	15.0	-	-	-	15.0
Available for sale	**3,538.1**	**-**	**-**		**3,538.1**	4,296.8	-	-	-	4,296.8
Fair value through profit or loss	**-**	**-**	**-**	**-**	**-**	582.4	-	-	-	582.4
Derivative financial instruments	**425.6**	**-**	**(0.1)**	**-**	**425.5**	370.1	-	-	-	370.1
Other assets	**341.5**	**-**	**-**	**-**	**341.5**	430.1	-	-	-	430.1
Total assets	**27,500.1**	**52.8**	**34.1**	**1.3**	**27,588.3**	28,916.4	61.5	49.1	1.3	29,028.3
Liabilities										
Deposits by banks	**1,198.6**	**-**	**-**	**-**	**1,198.6**	715.4	-	10.5	-	725.9
Customer accounts	**22,374.4**	**20.4**	**30.3**	**-**	**22,425.1**	22,684.0	17.6	28.8	1.6	22,732.0
Customer accounts – capital bonds	**11.8**	**-**	**-**	**-**	**11.8**	77.4	-	-	-	77.4
Debt securities in issue[1]	**1,209.1**	**232.1**	**184.2**	**-**	**1,625.4**	1,466.4	549.6	538.3	-	2,554.3
Derivative financial instruments	**444.5**	**-**	**-**	**-**	**444.5**	346.9	-	-	-	346.9
Other borrowed funds	**472.6**	**-**	**-**	**-**	**472.6**	459.9	-	-	-	459.9
Other liabilities	**448.1**	**2.3**	**1.3**	**0.1**	**451.8**	770.3	0.4	(2.1)	-	768.6
Total liabilities	**26,159.1**	**254.8**	**215.8**	**0.1**	**26,629.8**	26,520.3	567.6	575.5	1.6	27,665.0
Net assets	**1,341.0**	**(202.0)**	**(181.7)**	**1.2**	**958.5**	2,396.1	(506.1)	(526.4)	(0.3)	1,363.3

1. The debt securities are shown gross of Fair Value Adjustment for the Dollar and Euro values.

At 31 December 2016, the Bank's open currency position was £1.4m (2015: £(0.7)m). The Bank manages its currency positions against both an overall limit and individual currency limits.

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

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

Other sources of market risk – unaudited

Other sources of market risk include:

- Prepayment risk – the risk that an asset or liability repays more quickly or slowly than anticipated, resulting in a mismatch between the asset, liability and associated hedge;
- Pipeline risk – the risk that the sales profile for new fixed rate products do not match hedging assumptions, resulting in a mismatch between amount of product sold and that hedged, which can result in a hedge rebalancing cost;
- Equity price risk – the risk that the fair value of equities decreases as a result of changes in the level of equity indices and individual stocks. The Bank's non-trading equity price risk exposure arises from equity securities classified as available-for-sale. A 10 percent increase in the value of the Bank's available for sale equities at 31 December 2016 would have increased equity by £4.7m (2015: £5.6m). An equivalent decrease would reduce equity by the same degree;
- Explicit option risk – the sensitivity to overall direction of interest rates, speed of change of interest rates and market prices for positions which contain explicit options e.g. caps, floors, 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
- Illiquidity risk – the Bank's risk appetite for market risk considers an illiquidity risk which is reflected in the assumed holding period it uses to assess its capital requirements for market risk.

Unaudited

	31 December 2016	31 December 2015
Total PV01 (£k)	**(5.0)**	76.0
Average PV01 for the year (£k)	**61.9**	(94.2)
Largest Positive PV01 for the period (£k)	**178.0**	128.0
Largest Negative PV01 for the period (£k)	**(5.0)**	(348.2)
Average basis risk (% of annual NII)	**0.5%**	3.4%
Swap spread PV01 (£k)	**(892.0)**	(1,043.0)
Average swap spread PV01 (£k)	**(921.5)**	(1,014.1)
MBS Holding (£m)	**1,318.0**	1,614.0
Average MBS Holding (£m)	**1,457.3**	857.2
FX notional (£m)	**1.4**	(0.7)
Average FX notional (£m)	**0.3**	(0.7)

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. During 2016 the largest absolute PV01 exposure of £178k reflected the short term impact following a reassessment of the level of stable non-interest bearing current accounts. This exposure was subsequently reducing as appropriate hedging activity was undertaken.

The Bank's basis risk exposure in terms of potential earnings at risk and notional has remained relatively stable through 2016 and primarily reflects a net LIBOR asset funded by administered rate liability. Swap spread risk has reduced through 2016 due to a reduction in both notional value and duration of the fixed rate sovereign bonds held within its liquid asset portfolio. MBS holdings have reduced by approximately £300m reflecting an outright sale of a portion of the Bank's Warwick Finance holdings and the impact of the quarterly pay down of these notes.

5. Pension Risk

5.1 Overview - Unaudited
Pension risk occurs in defined benefit schemes when the market value of the scheme's assets is considered to be insufficient to meet its liabilities, resulting in a deficit which the employer is legally obliged to fund. The scheme's liabilities are calculated using a discount rate referenced to UK Government bond yields and are an estimate of its long term obligations. Uncertainty in the estimated size of the liabilities and volatility in future investment returns from the assets may cause adverse movements in the pension fund deficit. The key risk factors that can have a positive or negative impact on the deficit are:

- Long term interest rates – a decrease in long term interest rates will cause the value of the scheme's liabilities to increase.

- Inflation – where a scheme's benefits have an inflation link an increase in inflation will cause the scheme's liabilities to increase. This may be offset where the scheme's assets are also linked to inflation (e.g. index-linked gilts and inflation swaps).

- Longevity risk (life expectancy) – the valuation of pension scheme liabilities is reliant on scheme member longevity and liabilities may substantially increase should longevity increase more than expected.

- Asset volatility – changes in the value of the scheme's assets compared to that of its liabilities can create significant volatility in the estimated deficit. This is particularly prevalent in schemes with significant equity holdings where equity returns underperform the bond yields used to discount scheme liabilities.

In 2015 the Bank closed its defined benefit scheme and removed the link to final pensionable salary for both Pace and Britannia Pension Scheme members. Colleagues are provided with defined contribution pension options for all future service. During 2016 consideration was given to strategies for separation of the Bank's share of the Pace scheme from that of The Co-operative Group.

Controls are applied to mitigate these risks and a monthly pension risk report is made to the Bank Asset and Liability Committee 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 engage the Trustees of Pace through its relationship with the sponsor, The Co-operative Group.

The Risk Director chairs a monthly pension steering group and pension risk is discussed at a number of Executive and Board Committees on a regular basis. For further information see note 33 of the Bank financial statements.

6. Regulatory Risk

6.1 Overview - Unaudited

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 including prudential and conduct of business regulations. The requirements often reflect global standards developed by, among others, the Basel Committee on Banking Supervision and the International Organisation of Securities Commissions. Requirements are increasingly derived from, or applied directly by, EU legislation in addition to the requirements mandated by the principal regulatory authorities that supervise the Bank in the jurisdictions in which it operates.

6.2 Changes to regulations - Unaudited

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 regulations. Adoption of these changes is owned and managed by the 1st line.

6.3 Regulatory Risk management - Unaudited

The Regulatory Risk function is responsible for monitoring and reporting on regulatory risk across the Bank and facilitates production of regulatory, conduct, anti-money laundering and financial crime risk reporting to CRROC, EROC and the Risk committee of the Bank.

7. Conduct Risk

7.1 Overview - Unaudited

The Bank manages conduct risk in a way that is consistent with its overall risk appetite and aligns with its strategy. Conduct risk 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, e.g. products and services not meeting the needs of its customers, sales processes resulting in poor advice or incorrect information, or failing to deal with a complaint appropriately. When assessing conduct risk there will often be a closely linked regulatory requirement arising from the Financial Conduct Authority (FCA) rules and guidance that are concerned with the conduct of business regulation.

8. Capital management

8.1 Overview - Unaudited

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

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

Throughout 2016 the Bank has continued to make progress towards reducing its overall risk profile. Non-core RWAs have reduced to £2.0bn from £2.8bn due to continued deleverage activity in its Legacy Portfolio. Core Credit Risk RWAs have increased by £0.2bn to £3.9bn reflecting growth in the Bank's retail mortgage assets.

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

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

Following the significant deleverage of the Optimum balances in 2015, the Bank judged it appropriate to reduce the temporary adjustment from £1.0bn to £0.3bn in line with the balance reduction in order to ensure that the Optimum RWAs were more reflective of the underlying credit quality of the reduced size of the portfolio. Having conducted further analysis, the Bank now intends to remove the remaining £0.3bn temporary adjustments in March 2017.

The Bank continues to meet its Pillar 1 capital requirements under normal economic conditions. This is the minimum required under the CRR. The PRA provides Individual Capital Guidance (ICG) for each bank, which represents guidance on the additional capital (Pillar 2a) a firm should hold in excess of Pillar 1. The PRA issued the Bank a revised ICG requirement in 2016 which came in force from 1 November 2016. Due to ongoing losses, the Bank breached its ICG throughout 2016 prior to the receipt of its new ICG and is in deficit to its new requirements at 31 December 2016. The Bank does not currently have sufficient capital resources to withstand a severe stress scenario under its current in force PRA buffer.

For any forward looking statements on capital refer to the Principal Risks and Uncertainties and Going Concern disclosures.

Key capital highlights are:

- CET1 ratio has decreased to 11.0% as at 31 December 2016 (31 December 2015: 15.5%) with a decrease in risk weighted assets of £0.7bn and a reduction in CET1 of £0.4bn.
- The Bank's leverage ratio is 2.6%, down 1.2% from 31 December 2015, reflecting the reduction in CET1 capital driven by the statutory loss in the year. The Bank is not currently subject to the 3% minimum requirement as it has retail deposit levels below £50bn, the threshold at which it becomes a binding requirement.
- The Bank is in breach of its ICG, being the PRA's statement as to the regulatory capital it expects the Bank to hold, due to the Bank's ongoing losses. The Bank met the Pillar 1 requirement throughout 2016.

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

8.3 Capital Stress Testing - Unaudited
The Bank uses stress testing as part of its assessment of capital adequacy within its

- Annual strategic planning process;
- ICAAP; and
- forecasting exercises.

Stress testing is embedded within the Bank's financial planning process, with stressed scenarios and sensitivities applied to the Bank's latest forecasts at least on an annual basis or more frequently as required. This enables the Bank's senior management and Board to assess the Bank's latest Plan or forecast under adverse scenarios to ensure it remains within risk appetite. Where outcomes fall outside of risk appetite, management actions are identified and embedded to return the position to within the risk appetite or they are either risk accepted.

Scenarios capture a selection 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 scenarios, as well as its own bespoke idiosyncratic scenarios.

Individual business areas prepare business plans as part of the Strategic Planning process. Stress testing models are utilised to stress business plans over a forward looking 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 as part of the Bank's RMF.

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 Bank currently has limited resiliency to severe stress.

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 change 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 submitted a Revised Plan which was accepted by the PRA in December 2014. This Plan was designed to enable the Bank to withstand a severe stress by the end of the planning horizon.

Following the stress assessment the Bank was not included in the 2015 or 2016 Bank of England stress tests, as these tests are designed to assess resilience to a deterioration in global economic conditions. The Bank was not included as a result of the size of the Bank's balance sheet, which is significantly smaller than the other firms that were included in the stress test; therefore the resilience of the Bank is unlikely to affect the resilience of the financial system as a whole.

The Bank remains a non-member of the UK concurrent stress testing regime. However, as part of its annual planning process the Bank undertakes appropriate stress testing and the results are discussed with the regulator as part of the ICAAP submission.

8.4 Capital resources CRD IV - Unaudited

	31 December 2016	31 December 2015
Common Equity Tier 1 (CET1): instruments and reserves		
Permanent share capital and the related share premium account	**1,759.5**	1,759.5
Retained earnings	**(896.4)**	(273.1)
Available for sale and cash flow hedge reserves	**94.6**	90.2
Defined benefit reserves	**9.5**	-
Other Reserves[1]	**410.0**	410.0
CET1 before regulatory adjustments	**1,377.2**	1,986.6
CET1: regulatory adjustments		
Prudential valuation in trading book	**(5.4)**	(0.8)
Intangible assets (net of related tax liability)	**(100.1)**	(142.8)
Defined Benefit Pension	**(15.3)**	-
Deferred tax assets not arising from temporary differences	**-**	(4.0)
Cash flow hedge reserves	**(56.4)**	(34.6)
Expected loss shortfall	**(44.4)**	(30.0)
Losses for the period [2]	**(418.7)**	(623.3)
Total regulatory adjustments to CET1	**(640.3)**	(835.5)
CET1	**736.9**	1,151.1
Additional Tier 1 (AT1) capital: instruments		-
Total regulatory adjustments to AT1 capital	**-**	-
Total Tier 1 capital (T1 = CET1 +AT1)	**736.9**	1,151.1
Tier 2 (T2) capital: instruments and provisions		
Capital instruments	**447.0**	448.4
Credit risk adjustments	**-**	-
T2 capital before regulatory adjustments	**447.0**	448.4
Total regulatory adjustments to T2 capital	**-**	-
T2 capital	**447.0**	448.4
Total capital (TC = T1 + T2)	**1,183.9**	1,599.5

1. Other reserves include the capital redemption reserve created as a result of the Bank's Liability Management Exercise in 2013.
2. A reconciliation of statutory to regulatory loss for the year is included in section 8.7.

8.5 Capital ratios and Risk Weighted Assets - Unaudited

	31 December 2016	31 December 2015
Capital ratios		
Common Equity Tier 1 ratio	**11.0%**	15.5%
Tier 1 ratio	**11.0%**	15.5%
Total capital ratio	**17.7%**	21.6%

Risk weighted assets		
Credit risk	**5,944.0**	6,517.6
Market risk	**-**	-
Operational risk	**732.1**	905.3
Total risk weighted assets	**6,676.1**	7,422.9

Segmental analysis of credit risk weighted assets		
Core		
Retail	**1,919.9**	1,810.9
BaCB	**485.3**	496.8
Treasury and Other	**1,498.4**	1,440.8
Total Core	**3,903.6**	3,748.5
Non-core		
Legacy Portfolio	**1,140.6**	1,793.1
Optimum	**899.8**	976.0
Total Non-core	**2,040.4**	2,769.1
Total credit risk weighted assets	**5,944.0**	6,517.6

CET1 ratio has decreased to 11.0% from 15.5% as at 31 December 2015. This reflects a reduction in CET1 of £0.4bn partially offset by a decrease in risk weighted assets of £0.7bn. The move in CET1 reflects a £418.7m regulatory loss for the year.

Non-core RWAs have reduced from £2.8bn to £2.0bn, driven by the continued deleverage of the Legacy Portfolio and natural run off within Optimum.

Core Credit Risk RWAs have increased by £0.2bn primarily driven by an overall increase in the mortgage portfolio. Operational Risk RWAs have decreased by £0.2bn following the annual recalculation of the Pillar 1 operational risk requirement subsequent to the 2015 year end results.

8.6 Reconciliation of equity per balance sheet to total capital as at 31 December 2016 - Unaudited

Balance sheet presentation	**Balance per accounts**	**Regulatory presentation**	**Regulatory Balance treatment**	**Cash flow hedge reserve**	**Regulatory treatment of deferred tax liability/asset**	**Expected losses**	**Prudent valuation in trading book**	**Capital Resources**
		Equity						
Ordinary share capital	**22.6**	Paid up capital instruments	**22.6**	**-**	**-**	**-**	**-**	**22.6**
Share premium account	**1,736.9**	Share Premium	**1,736.9**	**-**	**-**	**-**	**-**	**1,736.9**
Retained earnings	**(1,315.1)**	Retained earnings	**(896.4)**	**-**	**-**			**(896.4)**
		Regulatory losses for the period	**(418.7)**	**-**	**-**	**-**	**-**	**(418.7)**
Available for sale reserve	**38.2**	Available for sale reserve	**38.2**	**-**	**-**	**-**	**-**	**38.2**
Cash flow hedging reserve	**56.4**	Cash flow hedging reserve	**56.4**	**(56.4)**	**-**	**-**	**-**	**-**
Defined Benefit Pension Reserve	**9.5**	Defined Benefit Pension Reserve	**9.5**	**-**	**(15.3)**	**-**	**-**	**(5.8)**
Capital redemption reserve	**410.0**	Other reserves	**410.0**	**-**	**-**	**-**	**-**	**410.0**
		Total Equity	**958.5**	**(56.4)**	**(15.3)**	**-**	**-**	**886.8**
		Non-Equity						
Other borrowed funds	**447.0**	Capital instruments	**447.0**	**-**	**-**	**-**	**-**	**447.0**
Intangible assets	**(100.1)**	Intangible assets (net related tax liability)	**(100.1)**	**-**	**-**	**-**	**-**	**(100.1)**
Credit risk adjustment[1]	**112.0**	Expected loss shortfall	**112.0**	**-**	**-**	**(156.4)**	**-**	**(44.4)**
		Expected loss Tier 2 add-back	**-**	**-**	**-**	**-**	**-**	**-**
		Prudent valuation	**-**	**-**	**-**	**-**	**(5.4)**	**(5.4)**
		Total Non-Equity	**458.9**	**-**	**-**	**(156.4)**	**(5.4)**	**297.1**
		Total balances subject to own funds calculations	**1,417.4**	**(56.4)**	**(15.3)**	**(156.4)**	**(5.4)**	**1,183.9**

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

8.7 Reconciliation of statutory to regulatory loss for the period -Unaudited

	Year to 31 December 2016	Year to 31 December 2015
Statutory loss for the period	**(418.7)**	(622.8)
Statutory loss attributable to minority shareholders	**-**	(0.5)
Regulatory loss for the period	**(418.7)**	(623.3)

8.8 Leverage ratio - Unaudited

Leverage ratio common disclosure

		2016	2015
	On-balance sheet exposures (excluding derivatives and STFs)		
1	On-balance sheet items (excluding derivatives, SFTs and fiduciary assets, but including collateral)	**26,999.5**	28,751.0
2	(Asset amounts deducted in determining Tier 1 capital)	**(221.6)**	(212.2)
3	Total on-balance sheet exposures (excluding derivatives, SFTs and fiduciary assets)	**26,777.9**	28,538.8
	Derivative exposures		
4	Replacement cost associated with all derivatives transactions (i.e. net of eligible cash variation margin)	**318.8**	244.0
5	Add-on amounts for PFE associated with all derivatives transactions (mark-to-market method)	**42.9**	100.5
EU -5a	Exposure determined under Original Exposure Method	**-**	-
6	Gross-up for derivatives collateral provided where deducted from the balance sheet assets pursuant to the applicable accounting framework	**316.7**	229.3
7	(deductions of receivables assets for cash variation margin provided in derivatives transactions)	**-**	-
8	(Exempted CCP leg of client-cleared trade exposures)	**-**	-
9	Adjusted effective notional amount of written credit derivatives	**-**	-
10	(Adjusted effective notional offsets and add-on deductions for written credit derivatives)	**-**	-
11	Total derivative exposures	**678.4**	573.8
	Securities financing transaction exposures		
12	Gross SFT assets (with no recognition of netting), after adjusting for sales accounting transactions	**1,436.1**	731.4
13	(Netted amounts of cash payables and cash receivables of gross SFT assets)	**(1,347.4)**	(671.3)
14	Counterparty credit risk exposure for SFT assets	**36.1**	26.0
EU-14a	Derogation for SFTs: Counterparty credit risk exposure in accordance with Article 429b (4) and 222 of regulation (EU) No 575/2013	**-**	-
15	Agent transaction exposures	**-**	-
EU-15a	(Exempted CCP leg of client-cleared SFT exposure)	**-**	-
16	Total securities financing transaction exposures	**124.8**	86.1
	Other off-balance sheet exposures		
17	Off-balance sheet exposures at gross notional amount	**2,289.6**	2,592.8
18	(Adjustments for conversion at credit equivalent amounts)	**(1,471.0)**	(1,654.2)
19	Total off-balance sheet exposures	**818.6**	938.6
	Exempted exposures in accordance with CRR Article 429 (7) and (14) (on and off balance sheet)		
EU-19a	(Exemption of intragroup exposures (solo basis) in accordance with Article 429(7) of Regulation EU No 575/2013 (on and off balance sheet))	**-**	-
EU-19b	(Exposures exempted in accordance with Article 429(14) of Regulation (EU)No 575/2013 (on and off balance sheet)	**-**	-
	Capital and total exposures		
20	Tier 1 capital	**736.9**	1,151.1
21	**Total leverage ratio exposures**	**28,399.7**	30,137.3
	Leverage ratio		
22	Leverage ratio	**2.6%**	3.8%
	Choice on transitional arrangements and amount of derecognised fiduciary items		
EU-23	Choice on transitional arrangements for the definition of the capital measure		
EU-24	Amount of derecognised fiduciary items in accordance with Article 429(11) or Regulation (EU) No 575/2013	**-**	-

The leverage ratio has been calculated using the exposure basis within the European Commission delegated act.

Disclosure on qualitative items

1	Description of the processes used to manage the risk of excessive leverage
	The Bank is not subject to a regulatory minimum in relation to the leverage ratio however, leverage ratio remains embedded within the Bank's Planning and Reporting processes. The leverage ratio is part of the Bank's risk appetite framework, and is part of the management information provided to the Asset and Liability Committee (ALCO) and Capital Management Forum (CMF) and is a key consideration in the Bank's Strategic Planning process. Additionally, the leverage ratio is stressed as part of the Bank's ICAAP.
2	Description of the factors that had an impact on the leverage ratio during the period to which the disclosed leverage ratio refers
	The Bank's leverage ratio is 2.6%, down 1.2% from 31 December 2015 reflecting the reduction in CET1 capital driven by the statutory loss in the year. Leverage ratio exposures have reduced by £1.7bn primarily as a result of contraction in the Bank's balance sheet particularly the Non-Core portfolios.

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INDEPENDENT AUDITOR'S REPORT

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 2016 set out on pages 136 to 251. 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 2016 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 1.2 of the Basis of Preparation note of the financial statements on page 154 concerning the Company's ability to continue as a going concern. In that section the Directors set out the risks associated with the proposed Bank sale process and the successful execution of the Bank's 2017-2021 Strategic Plan (the Plan). These matters represent material uncertainties which may cast significant doubt upon the Company's ability to continue as a going concern. These financial statements do not include the adjustments that would result if the Company was unable to continue as a going concern.

What have we audited?
We have audited the financial statements of the Bank and the Company for the year ended 31 December 2016, which comprise:

- the Bank income statement;
- the Bank statement of comprehensive income;
- the Bank and Company balance sheet;
- the Bank and Company statement of cash flows;
- the Bank and Company statement of changes in equity; and
- the Bank and Company accounting policies and the related notes set out on pages 158 to 167.

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 Company financial statements, as applied in accordance with the provisions of the Companies Act 2006.

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;
- Financial Statement Close Process (FSCP);
- Valuation of impairment provisions;
- 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); and
- Recognition of income using the Effective Interest Rate (EIR) method.

We classified the first two risks, 'Going concern' and 'The Bank's control environment', as pervasive matters and treated them accordingly during our audit as described below. The other risks were seen as highlighting matters that gave rise to a more specific risk of material misstatement within the financial statements.

These six risks are generally consistent with the nature of six of the risks considered during our 2015 financial year audit.
In relation to our 2015 audit there were four further risks that for 2016 are considered to have a lower likelihood of material misstatement and as a result had a lesser effect on our overall audit strategy; on the allocation of resources on the audit; and on directing the efforts of the engagement team. These were as follows and the rationale behind their removal is also explained:

Fair value of derivatives with higher estimation uncertainty and hedge accounting:
The Bank's derivative portfolio has reduced in complexity in 2016 and as such the inherent risk related to the fair value of derivatives is lower. In addition, based on the results of our audit of the 2015 financial statements, we noted that the Bank has improved its processes over derivative valuation methodologies, resulting in no material discrepancies in derivative fair values being identified for that period. As a result, the likelihood of a material misstatement arising in this area is no longer considered to be high.

Release of fair value adjustments in relation to Leek notes: The fair value unwind of the Leek notes remains material in magnitude. However, due to the reduction of complexity involved as these adjustments reach their maturity, the likelihood of a material misstatement in relation to this matter is no longer considered to be high.

Separation from The Co-operative Group (TCG): The provision for separation was established in the 2014 and 2015 financial periods and therefore as the separation programme advances, complexity in the provisioning judgements has reduced and likelihood of material misstatement is now lower.

Accounting for material transactions: In line with the Bank's Plan for 2015, a number of complex transactions were executed during that year – more so than in 2016. The primary drivers of those transactions were to implement changes to the Bank's operating infrastructure, reduce risk weighted assets, or reduce operating costs. The scale and complexity of these transactions in the one year in aggregate led to a significant audit risk for the 2015 financial year: 'Accounting for material transactions'. This area is not significant for 2016.

In addressing the six risks for 2016, we undertook the procedures below which were designed in the context of the materiality of the financial statements as a whole. Consequently, we do not express any opinion on any individual area taken in isolation.

In addition, we considered whether or not the following fraud risk factors were present in each of these risks and to what degree being:

- Management override of internal controls;
- Manipulation of revenue recognition; and
- Fraudulent financial reporting.

Our work in each area was specifically designed to address these risks.
Taking the two pervasive matters and then the risks of material misstatement in turn:

Issue	Our response to the issue	Key observations communicated to the Audit Committee
Going concern Refer to the Audit Committee Report (page 68); Accounting policies (page 158); and Note 1.2 of the Consolidated Financial Statements (page 154). As described in the basis of preparation note, the going concern status of the Bank is dependent on a successful whole-bank sale or on the successful execution of the Bank's 2017-2021 Strategic Plan (the Plan). This execution has significant risks and uncertainties associated with it 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, but are not limited to: • The management actions contained within the Plan carry significant execution risk and material uncertainty exists with regards to the eventual outcome; • The regulators' continued acceptance of the Bank's inability to meet regulatory requirements including CRR, ICG and PRA Buffer compliance; • The ability of the Bank to attract and retain customers given the uncertainties surrounding whether or not a sale process or an equity raising will be implemented, and related media speculation about the Bank's future; • The funding requirements of the Pace pension scheme materially exceeding current estimates, the last man standing clause being invoked should one or more participating employers fail, or the Bank being forced to pay for a greater proportion than currently envisaged; and • Outsourcing and transformation projects may be	**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 the successful execution of capital raising activities, should the proposed sale not progress, successful issuance of MREL eligible Tier 2 debt at rates acceptable to the Bank, the Bank's forecasted financial performance, economic forecasting across the plan horizon and forecasted conduct and impairment provision charges. Our challenge was undertaken with reference to our knowledge of the Bank and experience of the wider UK 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 and testing whether it incorporates appropriate and sufficient senior management and Board review and approval. When reviewing the Bank's assessment of its ability to withstand stressed conditions as defined by the PRA we considered market conditions and the Bank's plans to achieve further deleverage and retained earnings growth. Our review was undertaken in the light of the Bank's 2016 performance versus the 2016 – 2020 Plan. We regularly met with the PRA, the FCA and the Resolution Directorate of the Bank of England during the course of our work to understand their approach to the areas where they are currently refraining from taking further action pending the achievement of remedial plans by the Bank. We also assessed whether the Bank's disclosures in relation to going concern adequately reflected the associated principal risks and uncertainties.	We concluded that the referenced disclosures appropriately reflect the Directors' assessment of the Bank's position in relation to going concern. This conclusion is supported by our discussions with the regulators and also with the Bank's executive management and Board. We understand the regulators are holding the Bank to delivery of its Plan and the remediation actions therein. We included an emphasis of matter in this Audit Report highlighting that the matters described in these disclosures represent material uncertainties which may cast significant doubt upon the ability to continue as a going concern and that these financial statements do not include the adjustments that would result if either the Bank or the Company were unable to do so.

Issue	Our response to the issue	Key observations communicated to the Audit Committee
subject to significant risk of delay to completion, increased costs and operational disruption. The risk has increased during the year due to the declining capital position of the Bank and the Company.		
The Bank's control environment Please refer to page 73 (Audit Committee report). We continued to identify weaknesses in the Bank's control environment in excess of what would be considered normal in the banking industry. This limited the opportunities that we had to place audit reliance on the design, implementation and operating effectiveness of the key controls that management relies on for 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, and the retained evidence supporting the operation of these manual controls is frequently inadequate. This approach substantially increases operational risk, and required us to adopt increased substantive testing procedures in most areas of the Bank's operations. As described in the Annual Report and Accounts (ARA), the Bank's deployment of an effective Risk Management Framework has made progress during 2016 although the Bank acknowledges that further work is required in 2017 to ensure that this is of a consistent standard in all areas. As the robustness of financial reporting depends on the effective functioning of the underlying operational and financial IT systems, as well as on the effectiveness of the Bank's wider control environment, we deemed this matter to be a pervasive risk.	**Our response:** Our audit approach included an assessment of the quality and effectiveness of the key internal controls that management relies on for financial reporting. We planned our audit to place reliance, where both possible and appropriate, on those internal controls including general IT controls where these could be determined as operating effectively. 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 specific IT applications which are required to operate effectively to mitigate the risk of misstatement within the financial statements. Where we were unable to place such reliance we addressed the increased pervasive risk by designing and then undertaking audit procedures to obtain a greater proportion of evidence from substantive testing, for example, third party evidence, detailed testing of inter-system reconciliations between key systems for financial reporting, and increased sample sizes for our tests of balances.	We highlighted to the Audit Committee that although improvements had been made to the overall control environment in a number of areas, and as a result our scope of reliance over IT applications and controls had increased from 2015, for many processes and IT applications which are key for financial reporting the controls were not operating effectively. This led to us extending the scope of our work by identifying and testing compensating manual controls and undertaking further additional substantive testing. We satisfactorily obtained the necessary audit evidence from our additional substantive work.
The Bank's Financial Statement Close Process (FSCP), including the ledger close process and the consolidation, is heavily reliant on manual processes and the use of spreadsheets. FSCP remains organisationally complex as it is fragmented across multiple ledgers. A large number of manual adjustments needed to be posted directly into the ledgers, or into the consolidation working spreadsheet for the current year-end. Whilst the risk has decreased during the year due to improvements in the Bank's financial control and oversight process, we are of the view that there remains a significant risk that the primary financial statements or related disclosures may be misstated.	**Our response:** After assessing design and implementation, we chose to adopt a primarily substantive approach. Our testing included: • Examining Management's reconciliations between source systems and the general ledgers through to the consolidation spreadsheet, including substantiation of the source system balances; • Testing material post-closing adjustments to appropriate supporting evidence. We then considered whether the journals were posted appropriately and were consistent with our conclusions on the judgements and estimates made by Management; and • Reconciling and substantiating material intercompany adjustments.	We concluded to the Audit Committee that the level of manual processing within the Bank's FSCP is unusual in the banking industry. We also commented that the level of manual intervention had improved across the year but that a lack of automation and control around source system interfaces to legacy ledgers, consolidation and in the preparation of the notes to the financial statements remains an area of risk. Overall, as a result of our substantive testing procedures, we concluded that the Bank had satisfactorily managed the reporting risk within the FSCP.
Loan loss impairment Refer to the Audit Committee Report (page 71) and Note 1.3.5 of the Consolidated Financial Statements (page 161) The provision for impairment of loans and advances to customers is a significant balance and carries a high degree of estimation uncertainty derived from the assumptions used to build the provisions. The Bank continues to deleverage and reduce risk	**Our response:** We understood and tested key controls in relation to: • Management's review of corporate loan connections; • The governance over the collective impairment process; and • Management's review and approval process for the outputs of the collective impairment models	We concluded to the Audit Committee that the provision levels held by the Bank in relation to loan loss impairment were reasonably estimated. We highlighted to the Audit Committee that: • The level of estimation uncertainty in the corporate loan portfolio has reduced due to active management and resolution of default cases and through portfolio sales; • Key controls identified were found to be designed and operating effectively;

Issue	Our response to the issue	Key observations communicated to the Audit Committee
in its loan portfolio. However, due to the materiality of the provisions, the level of estimation uncertainty and the uncertain economic outlook in the UK, this continues to represent a significant audit risk. The level of risk remains significant in 2016.	including model adjustments. For a sample of individually impaired loans we obtained an understanding of the latest developments in the borrower's situation and the factors impacting the measurement of impairment provisions. In each case we tested key model inputs, reperformed Management's provision calculation and considered alternative scenarios in challenging Management's estimate. The Bank derives its individual impairment provisions with reference to the collateral held against each loan. Our approach included the use of our own valuation specialists to assess the market value of a sample of collateral valuations. Our substantive audit procedures over the collective provision models included assessing, challenging and substantiating the key assumptions, such as: emergence periods; probabilities of default; collateral valuations; forced sales discounts; loss given default; time from default to sale; and discount rates. We substantiated these assumptions by reference to historical data, external benchmarks and our knowledge of the Bank's portfolios, as applicable. The Bank applies a number of overlays to the collective provision models in order to adjust for shortfalls in risk models. We assessed the identified overlays for completeness using our knowledge and experience across the banking sector and tested each significant overlay for appropriateness of methodology. We tested the relevant credit risk data used within the Bank's models for completeness of capture and accuracy of extraction from the Bank's underlying systems. Using our in-house credit modelling specialists we tested the effectiveness of the Bank's impairment model validation process and also assessed the significant model assumptions and methodology used to calculate the model parameters, against established industry standards, to provide assurance over the calculation of the collective model provisions.	• The assessment of a sample of specific loan loss provisions, including the independent valuation of collateral, found that Management's estimates were reasonable and the collateral held was appropriately valued; • Data flows into the collective provision models were found to be materially complete and accurate; • The key assumptions incorporated within the collective provision models were found to be appropriately calculated, and supported by historical data; • Provision overlays were reasonable in the context of the Bank's portfolios; and • Model assumptions and methodology were found to be appropriate.
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). Please refer to page 71 (Audit Committee report), pages 169 to 170 (Critical Judgements and Estimates note) and pages 190 to 191 (financial disclosures) We are aware of industry wide issues that affect the Bank's business and products, past and present. Our risk is that the Bank has not adequately identified the matters that it could be liable for, or hasn't appropriately provided for those matters it has identified. The Bank carries a number of provisions for various matters including those related to the conduct of the Bank towards its past and present	**Our response:** We determined that controls were not designed effectively and as such we adopted a substantive approach. We tested the completeness and accuracy of data used in the provisioning models and the assessment of the provision and disclosure in accordance with the relevant accounting standards. We challenged the adequacy of provisions recognised by assessing and testing the key assumptions used within the provision models and comparing those assumptions to published peer data and the Bank's historical data. Our work included, amongst other things, reviewing regulatory correspondence, complaint logs and results of past business reviews. We also assessed the disclosures in order to determine whether the disclosures adequately	We concluded to the Audit Committee that the provision levels held by the Bank in relation to conduct risk and non-compliance with the CCA were reasonably estimated. We also concluded that the Bank's disclosures were appropriate and in compliance with relevant accounting standards. We highlighted to the Audit Committee that the Bank's estimates were in line with industry practice as a whole. However, the following factors amongst other matters, highlight this as the most subjective area of accounting estimation within these financial statements: • The continued presence of data gaps; • Uncertainty surrounding how the market will react

Issue	Our response to the issue	Key observations communicated to the Audit Committee
customers such as: • mis-selling Payment Protection Insurance (PPI); • mis-selling Packaged Bank Accounts (PBAs); • the Mortgages Rectification Programme (MRP); and • technical breaches of the Consumer Credit Act (CCA). 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 PPI, PBA, MRP and CCA is highly judgemental, as is the identification of affected populations. The disclosures in relation to customer redress need to appropriately reflect both the application of judgement by the Directors in estimating those required provisions, as well as contingent liabilities. Due to the materiality of the potential redress and the level of uncertainty involved this represents a significant audit risk. The level of risk has remained consistent with 2015.	articulated the uncertainties that existed in relation to the provisions recognised, including testing the disclosures on the sensitivity of the PPI provisions to changes in the underlying assumptions.	to the FCA's guidance in relation to both Plevin and the time barring of complaints; • The fact that in a number of areas the Bank's estimates continue to be model based and derived from historical customer claim patterns as opposed to being based on actual current pay out experience; and • Uncertainty surrounding any further legacy issues not as yet identified. As a result there remains a risk that actual outcomes will not match current best estimated forecasts. For the key judgements used in relation to PPI we found that the sensitivities disclosed were appropriate and materially accurate.
Recognition of income using the Effective Interest Rate method Refer to the Audit Committee Report (page 71); Accounting policies (page 159); and Note 38 of the Consolidated Financial Statements (page 206) The EIR 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 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 and the number of different products the Bank has across its loan portfolio, this is considered a significant risk. The level of risk has remained consistent with 2015.	**Our response:** After assessing the design and implementation of controls for setting and updating EIR assumptions and methodologies, we adopted a substantive approach with lower testing thresholds for our audit. We validated and challenged assumptions used by Management in the EIR models including the behavioural lives of assets and the forecasting of standard variable rates. We compared customer redemption assumptions with the recent customer redemption behaviours observable in the Bank's portfolios, and assessed the consistency of forecast standard variable rates with market derived base rate forecasts and the Bank's expectations of future interest margins. We reviewed the appropriateness of key model assumptions in light of our knowledge of the Bank's portfolios, market conditions and observed practice in the UK mortgage sector. We tested the completeness and accuracy of data within these models through sample testing from models to the source systems and vice-versa. We performed EIR recalculations by taking samples of tranches of mortgages and compared our results to the EIR balance as per the models to assess the integrity of the EIR formulae used in the models.	We concluded to the Audit Committee that the approach taken results in a reasonable and appropriate outcome in the context of current observable market behaviours and economic conditions. We also highlighted that there is subjectivity in Management's assumptions concerning behavioural lives and future rates of interest. We were satisfied that the assumptions made by management are reasonable in the context of the Bank's mortgage portfolios and current market conditions.

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's 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 Annual Report and Accounts 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.

Our application of materiality
We apply the concept of materiality in both planning and performing the audit, and in evaluating the effect of identified misstatements on our audit, on the financial statements and on forming our audit opinion.

Audit materiality
We define audit materiality as the magnitude of an omission or misstatement that, individually or in the aggregate, could reasonably be expected to influence the economic decisions of the users of the financial statements. Audit materiality provides a basis for determining the nature and extent of our audit procedures.

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 audit materiality for the Bank to be £10m (2015: £16m) which was 1% of the Bank's projected total year end equity at the time of assessment. 1% of this measure is at the lower end of our normal range. The reason for selecting this measure as the basis for our audit materiality consideration is that the Bank's stated focus is to both maintain and restore capital, and it has been loss making for several years. 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 audit 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.

During the course of our audit, we reassessed our initial audit materiality and maintained it at the level of £10m (2015: £16m) as, after discussion with the key stakeholders, we concluded the difference between expected and actual total year end equity was not significant enough to warrant a change.

Performance materiality
We define performance materiality as the level of materiality that we use at the individual account or balance level. It is set at an amount to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements exceeds audit materiality.

On the basis of our risk assessments, together with our assessment of the Bank's overall control environment, our judgement was that performance materiality should be set at 50% (2015: 50%) of our audit materiality, namely £5m (2015: £8m). 50% is at the conservative end of the normal range we use which is 50% to 75%. We have set performance materiality at this percentage due to the issues highlighted above as regards the Bank's overall control environment and also with regard to the level of audit differences that we have historically encountered.

Audit work at component locations for the purpose of obtaining audit coverage over significant financial statement accounts is undertaken based on a percentage of total performance materiality. The performance materiality set for the component is based on its relative scale and risk to the Bank as a whole and our assessment of the risk of misstatement in that component.

In the current year, performance materiality allocated to the component was £0.5m (2015: £0.8m).

Reporting threshold
Our reporting threshold is defined as the amount below which identified misstatements are considered to be clearly trivial.
We agreed with the Audit Committee that we would report to them all uncorrected audit differences in excess of £0.5m (2015: £0.8m), which is set at 5% of our audit materiality, as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds.
We evaluate any uncorrected misstatements against both the quantitative measures of materiality discussed above and in light of other relevant qualitative considerations in forming our opinion.

Respective responsibilities of the Directors and of ourselves as auditor
As explained more fully in the Directors' Responsibility Statement set out on page 87, 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.

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.

An overview of the scope of the audit
As highlighted, audit materiality for the financial statements as a whole was set at £10m.

The Bank is principally managed from one location in Manchester, with certain functions such as Treasury and some corporate activities operated from London. These functions and operations were subject to full scope audit procedures by the primary audit team, and comprise 99.9% (2015: 96%) of the Bank's operating income, 100% (2015: 100%) of the Bank's loss before taxation and 99.9% (2015: 99.8%) of the Bank's total assets.

One legal entity was considered separately: Britannia International Limited (BINT), which is based in the Isle of Man and has prepared financial information on a break-up basis as at 31 December 2016. This entity is not audited by Ernst & Young LLP and was subjected to a specific scope audit in relation to our audit of the Bank's financial statements.

Involvement of component auditors
Detailed audit instructions were sent to the auditor of the component. These instructions specified the significant audit areas that should be covered by the audit (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 auditor as necessary.

Our opinion on other matters prescribed by the Companies Act 2006 is unmodified
In our opinion, based on the work undertaken in the course of the audit:

- the information given in the Strategic Report and the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements; and
- the Strategic Report and the Directors' Report have been prepared in accordance with applicable legal requirements.

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, in our opinion, financial and non-financial information in the annual report is:

- materially inconsistent with the information in the audited financial statements; or
- apparently materially incorrect based on, or materially inconsistent with, our knowledge of the Bank acquired in the course of performing our audit; or
- otherwise misleading.

In particular, we are required to report to you if:

- we have identified any inconsistencies between our knowledge acquired in the course of performing the audit and the directors' statement that they consider the annual report and accounts taken as a whole is fair, balanced and understandable and provides the information necessary for shareholders to assess the entity's performance, business model and strategy; and
- the annual report appropriately addresses those matters that we communicated to the audit committee that we consider should have been disclosed.

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 light of the knowledge and understanding of the Company and its environment obtained in the course of the audit, we have identified no material misstatements in the Strategic Report or Directors' Report.
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' statements in relation to going concern, set out on page 154, and longer-term viability, set out on page 49; and
- the part of the Corporate Governance Statement on page 60 relating to the Company's compliance with the provisions of the UK Corporate Governance Code specified for our review.

We have nothing to report in respect of this review.

Statement on the Directors' Assessment of the principal risks that would threaten the solvency or liquidity of the entity

Under the ISAs (UK and Ireland) we are required to give a statement as to whether we have anything material to add or to draw attention to in relation to:

- the Directors' confirmation in the annual report that they have carried out a robust assessment of the principal risks facing the entity, including those that would threaten its business model, future performance, solvency or liquidity;
- the disclosures in the annual report that describe those risks and explain how they are being managed or mitigated;
- the Directors' statement in the financial statements about whether they considered it appropriate to adopt the going concern basis of accounting in preparing them, and their identification of any material uncertainties to the entity's ability to continue to do so over a period of at least 12 months from the date of approval of the financial statements; and
- the Directors' explanation in the annual report as to how they have assessed the prospects of the entity, over what period they have done so and why they consider that period to be appropriate, and their statement as to whether they have a reasonable expectation that the entity will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, including any related disclosures drawing attention to any necessary qualifications or assumptions.

We have nothing material to add, or to draw attention to, aside from the matter emphasised above.

Peter Wallace (Senior Statutory Auditor)
for and on behalf of Ernst & Young LLP, Statutory Auditor
London
08 March 2017

Notes:
1. The maintenance and integrity of The Co-operative Bank plc web site is the responsibility of the Directors; the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the web site.
2. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

The Bank income statement
For the year ended 31 December 2016
All amounts are stated in £m unless otherwise indicated

	Note	**2016**	2015
Interest receivable and similar income	6	**737.8**	821.6
Interest expense and similar charges	6	**(517.5)**	(522.4)
Net interest income		**220.3**	299.2
Fee and commission income	7	**88.7**	131.9
Fee and commission expense	7	**(47.8)**	(60.1)
Net fee and commission income		**40.9**	71.8
Income from investments		**0.2**	-
Other operating income/(expense)	8	**60.6**	(130.3)
Operating income		**322.0**	240.7
Operating expenses			
Operating expenses	9	**(783.2)**	(765.7)
Provision for customer redress	31	**(22.4)**	(134.9)
Total operating expenses		**(805.6)**	(900.6)
Operating losses before net impairment gains		**(483.6)**	(659.9)
Net impairment gains on loans and advances	16a	**6.2**	48.6
Operating loss		**(477.4)**	(611.3)
Share of post-tax profits from joint ventures	35	**0.3**	0.7
Loss before taxation		**(477.1)**	(610.6)
Income tax	11	**58.4**	(12.2)
Loss for the financial year		**(418.7)**	(622.8)
Attributable to:			
Equity shareholders		**(418.7)**	(623.3)
Non-controlling interests		**-**	0.5
		(418.7)	(622.8)
Loss per share (basic and fully diluted)	12	**(92.74)p**	(138.05)p

The notes on pages 151 to 220 form part of these financial statements.

The Bank statement of comprehensive income
For the year ended 31 December 2016
All amounts are stated in £m unless otherwise indicated

	2016			2015		
	Equity shareholders	**Non-controlling interests**	**Total**	Equity shareholders	Non-controlling interests	Total
(Loss)/profit for the year	**(418.7)**	**-**	**(418.7)**	(623.3)	0.5	(622.8)
Other comprehensive income that may be recycled to profit or loss:						
Changes in cash flow hedges:						
Net changes in fair value recognised directly in equity	**11.1**	**-**	**11.1**	(47.6)	(0.1)	(47.7)
Transfers from equity to income or expense	**18.0**	**-**	**18.0**	26.2	-	26.2
Taxation	**(7.3)**	**-**	**(7.3)**	(3.0)	-	(3.0)
Changes in available for sale assets:						
Net changes in fair value recognised directly in equity	**80.8**	**-**	**80.8**	19.1	-	19.1
Transfers from equity to income or expense	**(100.7)**	**-**	**(100.7)**	17.5	-	17.5
Taxation	**2.5**	**-**	**2.5**	(5.6)	-	(5.6)
Other comprehensive income that may not be recycled to profit or loss:						
Changes in net retirement benefit asset:						
Recognition of defined benefit asset	**81.7**	**-**	**81.7**	-	-	-
Defined benefit plan actuarial losses	**(68.4)**		**(68.4)**	-	-	-
Taxation	**(3.8)**	**-**	**(3.8)**	-	-	-
Other comprehensive income/(expense) for the financial year, net of income tax	**13.9**	**-**	**13.9**	6.6	(0.1)	6.5
Total comprehensive (expense)/income for the financial year	**(404.8)**	**-**	**(404.8)**	(616.7)	0.4	(616.3)

The notes on pages 151 to 220 form part of these financial statements.

The Bank balance sheet
At 31 December 2016
All amounts are stated in £m unless otherwise indicated

	Note	**2016**	2015
Assets			
Cash and balances at central banks	14	**2,848.2**	2,678.5
Loans and advances to banks	15	**836.9**	871.0
Loans and advances to customers	16a	**19,452.7**	19,690.4
Fair value adjustments for hedged risk	16b	**131.6**	94.0
Investment securities - loans and receivables	17a	**13.8**	15.0
Investment securities - available for sale	17b	**3,538.1**	4,296.8
Investment securities - fair value through profit or loss	17c	**-**	582.4
Derivative financial instruments	18	**425.5**	370.1
Non-current assets classified as held for sale	13	**5.3**	3.4
Equity shares	19	**46.8**	55.6
Investments in joint ventures	35	**6.0**	4.9
Investment properties	21	**2.2**	2.1
Property, plant and equipment	22	**35.4**	46.1
Intangible assets	20	**100.1**	142.8
Other assets	23	**96.7**	124.1
Prepayments and accrued income	24	**28.7**	43.5
Deferred tax assets	32	**-**	7.6
Net retirement benefit asset	33	**20.3**	-
Total assets		**27,588.3**	29,028.3
Liabilities			
Deposits by banks	25	**1,198.6**	725.9
Customer accounts		**22,425.1**	22,732.0
Customer accounts - capital bonds	26	**11.8**	77.4
Debt securities in issue	27	**1,625.4**	2,554.3
Derivative financial instruments	18	**444.5**	346.9
Other borrowed funds	28	**472.6**	459.9
Other liabilities	29	**45.9**	68.8
Accruals and deferred income	30	**115.3**	152.5
Provisions for liabilities and charges	31	**276.4**	499.2
Current tax liabilities		**-**	0.3
Deferred tax liabilities	32	**14.2**	47.8
Total liabilities		**26,629.8**	27,665.0
Capital and reserves attributable to the Bank's equity holders			
Ordinary share capital	37	**22.6**	22.6
Share premium account	37	**1,736.9**	1,736.9
Retained earnings		**(1,315.1)**	(896.4)
Available for sale reserve		**38.2**	55.6
Capital redemption reserve		**410.0**	410.0
Cash flow hedging reserve		**56.4**	34.6
Defined benefit pension reserve		**9.5**	-
Total equity		**958.5**	1,363.3
Total liabilities and equity		**27,588.3**	29,028.3

The notes on pages 151 to 220 form part of these financial statements.

Approved by the Board on 8 March 2017:

Dennis Holt, Chairman Liam Coleman, Chief Executive John Worth, Chief Financial Officer

The Bank statement of cash flows
For the year ended 31 December 2016
All amounts are stated in £m unless otherwise indicated

	2016	Re-presented 2015[1]
Cash flows used in operating activities:		
Loss before taxation	**(477.1)**	(610.6)
Adjustments for:		
Decrease/(increase) in prepayments and accrued income	**14.8**	(31.3)
(Decrease)/increase in accruals and deferred income	**(37.2)**	136.5
Interest payable in respect of other borrowed funds	**43.9**	28.6
Effect of exchange rate movements	**(8.2)**	0.2
Fair value movement on investment properties	**(0.2)**	-
Impairment gains on loans and advances	**(6.2)**	(48.6)
Fair value movement on loans and advances	**8.1**	-
Depreciation and amortisation	**41.1**	39.4
Impairment of intangible assets	**40.6**	1.3
Interest amortisation	**(12.6)**	6.6
Fair value movements and amortisation of financial assets and liabilities	**(82.2)**	(106.6)
Profit on disposal of investment securities	**(18.4)**	-
Impairment of property, plant and equipment	**0.5**	-
Gain on disposal of property, plant, equipment and software	**(4.8)**	(3.0)
Loss on sale of loans and advances to customers	**7.2**	-
Net loss on sale of subsidiaries	**-**	0.7
Unwind of fair value adjustments arising on transfer of engagements	**176.8**	117.2
	(313.9)	(469.6)
Increase in deposits by banks	**472.7**	110.5
Decrease in customer accounts and capital bonds	**(372.5)**	(7,068.4)
Decrease in debt securities in issue	**(1,105.7)**	(889.3)
(Increase)/decrease in loans and advances to banks	**(9.0)**	510.9
Decrease in loans and advances to customers	**239.7**	5,729.0
Net movement of other assets and other liabilities	**(139.3)**	93.5
Income tax received/(paid)	**0.4**	(0.1)
Net cash flows used in operating activities	**(1,227.6)**	(1,983.5)

	2016	Re-presented 2015[1]
Cash flows from/(used in) investing activities:		
Purchase of tangible and intangible fixed assets	**(39.7)**	(79.5)
Proceeds from sale of property, plant and equipment	**12.0**	21.4
Proceeds from sale of investment property	**0.1**	-
Proceeds from the sale of equity shares	**41.8**	-
Purchase of investment securities	**(363.7)**	(1,916.3)
Proceeds from sale and maturity of investment securities	**1,747.6**	1,269.9
Profit from sales of subsidiaries	**-**	30.2
Net cash flows from/(used in) investing activities	**1,398.1**	(674.3)

	2016	Re-presented 2015[1]
Cash flows (used in)/from financing activities:		
Interest paid on other borrowed funds	**(43.9)**	(28.6)
Issuance of other borrowed funds	**-**	249.0
Net cash flows (used in)/from financing activities	**(43.9)**	220.4

	Note	2016	Re-presented 2015[1]
Increase/(decrease) in cash and cash equivalents		**126.6**	(2,437.4)
Cash and cash equivalents at the beginning of the financial year		**3,139.7**	5,577.1
Cash and cash equivalents at the end of the financial year		**3,266.3**	3,139.7
Cash and balances with central banks	14	**2,807.2**	2,632.9
Loans and advances to banks	15	**459.1**	506.8
		3,266.3	3,139.7

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

The notes on pages 151 to 220 form part of these financial statements.

The Bank statement of changes in equity
For the year ended 31 December 2016
All amounts are stated in £m unless otherwise indicated

	Attributable to equity holders of the Bank									
	Share capital	**Share premium**	**Available for sale reserve**	**Cash flow hedging reserve**	**Capital redemption reserve**	**Defined benefit pension reserve**	**Retained earnings**	**Total**	**Non-controlling interest**	**Total equity**
2016										
Balance at the beginning of the year	**22.6**	**1,736.9**	**55.6**	**34.6**	**410.0**	**-**	**(896.4)**	**1,363.3**	**-**	**1,363.3**
Total comprehensive (expense)/income for the year	**-**	**-**	**(17.4)**	**21.8**	**-**	**9.5**	**(418.7)**	**(404.8)**	**-**	**(404.8)**
Disposal of UTB	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Balance at the end of the year	**22.6**	**1,736.9**	**38.2**	**56.4**	**410.0**	**9.5**	**(1,315.1)**	**958.5**	**-**	**958.5**

	Attributable to equity holders of the Bank									
	Share capital	Share premium	Available for sale reserve	Cash flow hedging reserve	Capital redemption reserve	Defined benefit pension reserve	Retained earnings	Total	Non-controlling interest	Total equity
2015										
Balance at the beginning of the year	22.6	1,736.9	24.6	59.0	410.0	-	(273.1)	1,980.0	34.5	2,014.5
Total comprehensive income/(expense) for the year	-	-	31.0	(24.4)	-	-	(623.3)	(616.7)	0.4	(616.3)
Disposal of UTB	-	-	-	-	-	-	-	-	(34.9)	(34.9)
Balance at the end of the year	22.6	1,736.9	55.6	34.6	410.0	-	(896.4)	1,363.3	-	1,363.3

The notes on pages 151 to 220 form part of these financial statements.

NOTES TO THE BANK FINANCIAL STATEMENTS
For the year ended 31 December 2016
All amounts are stated in £m unless otherwise indicated.

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 2016. The financial statements comprise all audited sections of the accounts. Where indicated, the Risk Management section and capital management section form part of the audited accounts.

1.1.1 Standards and interpretations issued and effective

During 2016, the Bank adopted the following amendments to standards and interpretations:

- 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 has had no material impact on the 2016 financial statements of the Bank.

- 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 amendments have had no material impact on the 2016 financial statements of the Bank.

- 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 amendments have had no material impact on the 2016 financial statements of the Bank.

- Amendments to IAS 1 (Presentation of Financial Statements)
  The narrow-focus amendments to IAS 1 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 amendments have had no material impact on the 2016 financial statements of the Bank.

- IAS 19 (Defined Benefit Plans (2013))
  This amendment clarifies the requirements that relate to how contributions from employees or third parties that are linked to service should be attributed to periods of service. In addition, it permits a practical expedient if the amount of the contributions is independent of the number of years of service, in that contributions can, but are not required, to be recognised as a reduction in the service cost in the period in which the related service is rendered. The standard is mandatory for years beginning on or after 1 February 2015 but is available for early adoption. The amendments have had no material impact on the 2016 financial statements of the Bank.

- Annual improvements 2014
  The IASB has made amendments to the following standards that are relevant to the Group and Company: IFRS 5 'Non-current Assets Held for Sale and Discontinued Operations', IFRS 7 'Financial Instruments: Disclosures', IAS 19 'Employee Benefits' and IAS 34 'Interim Financial Reporting'. The amendments have had no material impact on the 2016 financial statements of the Bank.

1.1.2 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)
  In July 2014, the IASB issued IFRS 9 (Financial Instruments), which is the comprehensive standard to replace IAS 39 'Financial Instruments: Recognition and Measurement' and is effective for periods beginning on or after 1 January 2018, and was endorsed by the EU on 22 November 2016. IFRS 9 includes requirements for classification and measurement of financial assets and liabilities, impairment of financial assets and hedge accounting.

Classification and Measurement
The classification and measurement of financial assets will depend on:

- how the Bank manages such assets (the entity's business model); and

- the contractual cash flow characteristics of the financial asset (whether the cash flows represent 'solely payments of principal and interest').

The above factors determine whether the financial assets are measured at amortised cost, fair value through other comprehensive income (FVOCI) or fair value through profit or loss (FVTPL). The initial assessment of the classification and measurement of financial instruments held by the Bank has been completed. Based on this initial assessment, the Bank does anticipate some changes to the populations of assets measured at amortised cost and fair value but does not anticipate that the overall impact will be significant.

The classification and measurement of financial liabilities under IFRS 9 is not materially different to the current requirements under IAS 39, with the exception for certain liabilities measured at fair value, where gains or losses relating to changes in the entity's own credit risk are to be included in other comprehensive income as oppose to profit or loss under current rules. The Bank does not currently measure its own debt securities in issue at fair value under IAS 39.

The classification and measurement of all financial instruments will be reviewed prior to implementation on 1 January 2018 to ensure that:

- any changes to business models resulting from strategic decisions made by the Bank are captured within the final IFRS 9 classification and measurement of financial instruments on transition; and

- the contractual cash flow characteristics and business model for any new types of financial instruments are captured.

The Bank will provide details of the quantitative impact of applying the classification and measurement requirements of IFRS 9 once it is practicable to provide reliable estimates. The parallel run of the classification and measurement requirements of IFRS 9 which is planned to take place in the second half of 2017 is expected to provide reliable quantitative impact information which will be disclosed in the Bank's 2017 ARA.

Impairment
IFRS 9 requires entities to recognise expected credit losses based on unbiased forward-looking information, as compared to the existing incurred loss model. The impairment requirements of IFRS 9 apply to financial assets measured at amortised cost and FVOCI, lease receivables and certain loan commitments, and financial guarantee contracts.

The salient features of impairment model development which are expected to persist at transition are:

- A PD, LGD, EAD approach;

- The Bank will apply qualitative and quantitative approaches in determining transition from stage 1 to stage 2. Whilst the Bank has defined appropriate parameters as part of model development for a number of portfolios, refinement is expected as part of the parallel run;

- A days past due backstop is expected to be applied for transitioning to stage 2 and stage 3 respectively;

- Probationary periods will be applied in respect of backwards transitions from stage 3 to 2 and stage 2 to 1. Whilst the Bank has defined appropriate periods as part of model development for a number of portfolios, refinement is expected as part of the parallel run;

- The low credit risk assumption will be restricted to certain high quality treasury assets;

- Incorporation of forward looking information by applying the Bank's outlook of economic and non-economic factors; and

- A probability weighted range of possible outcomes will be captured within the impairment models by incorporating multiple economic scenarios.

The extent to which expert judgement is required to be applied is anticipated to be borne out of the parallel run. Such expert judgement may ultimately comprise intra or extra model adjustments. Model refinement is expected as part of the parallel run and as any further authoritative guidance is issued.

The Bank will provide details of the quantitative impact of applying the impairment requirements of IFRS 9 once it is practicable to provide reliable estimates. A quantitative impact assessment will be disclosed in the Bank's 2017 ARA following the completion of the parallel run in the second half of 2017.

Hedge accounting
The principles of micro hedge accounting under IFRS 9 were set out within the Bank's 2015 ARA and are not repeated within this document. The Bank has elected to adopt an IFRS 9 basis for micro hedge accounting whilst continuing macro hedging under IAS 39. Whilst the disclosure requirements of micro hedge accounting under IFRS 9 are different to that under IAS 39, the adoption of an IFRS 9 basis for micro hedge accounting is not expected to have a significant impact on the Bank's financial statements on transition on 1 January 2018. A parallel run of the micro hedge accounting requirements of IFRS 9 is planned to take place in the second half of 2017.

Governance
Accounting policy and other key judgements made as part of model development are, and will continue to be, subject to appropriate governance within both Risk and Finance. The impairment models are subject to governance commensurate with their relative impact on the Bank.

As part of the planning for the classification and measurement, impairment and hedge accounting parallel runs, the Bank is considering the appropriateness of current business as usual governance practices (e.g. Watchlist reviews) and will enhance as necessary. Governance refinement is expected to take place as part of the impairment parallel run.

Capital planning
The impact of IFRS 9 is considered as part of the Bank's capital planning and will apply any IFRS 9 related transitional or permanent capital rules when issued and effective.

1.1.3 Other standards

- 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 supersedes IAS 18 (Revenue) and a number of revenue interpretations.

  The standard will be effective for annual reporting years beginning on or after 1 January 2018 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.

- 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 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 effective date for the amendments is yet to be determined and has not yet been adopted by the EU. The impact to the Bank is likely to be immaterial.

- Amendments to IAS 7 (Statement of Cash Flows)
  The amendments require disclosure of information enabling users of financial statements to evaluate changes in liabilities arising from financing activities. The amendments do not define financing activities, instead they clarify that financing activities are based on the existing definition used in IAS 7.

  The amendment is effective for reporting periods beginning on or after 1 January 2017 but is available for early adoption subject to EU endorsement. The impact to the Bank is likely to be immaterial.

- IFRS 16 (Leases)
  The IASB has published a new standard, IFRS 16 'Leases'. The new standard brings most leases on-balance sheet for lessees under a single model, eliminating the distinction between operating and finance leases. Lessor accounting however remains largely unchanged and the distinction between operating and finance leases is retained. IFRS 16 supersedes IAS 17 'Leases' and related interpretations and is effective for periods beginning on or after 1 January 2019, with earlier adoption permitted if IFRS 15 'Revenue from Contracts with Customers' has also been applied. The impact to the Bank of the new standard has not yet been quantified.

- Amendments to IAS 12 (Income taxes)
  These amendments on the recognition of deferred tax assets for unrealised losses clarify how to account for deferred tax assets related to debt instruments measured at fair value.

  The amendment is effective for reporting periods beginning on or after 1 January 2017 but is available for early adoption subject to EU endorsement. The impact to the Bank is likely to be immaterial.

- Amendments to IFRS 2 (Share based payments)
  This amendment clarifies the measurement basis for cash-settled, share-based payments and the accounting for modifications that change an award from cash-settled to equity-settled. It also introduces an exception to the principles in IFRS 2 that will require an award to be treated as if it was wholly equity-settled, where an employer is obliged to withhold an amount for the employee's tax obligation associated with a share-based payment and pay that amount to the tax authority.

- The amendments are effective for reporting periods beginning on or after 1 January 2018 but are available for early adoption subject to EU endorsement. The impact to the Bank of the amendments has not yet been quantified.

Other standards and interpretations have been issued but these are not considered to be relevant to the Bank's operations. The Bank intends to comply with the standards from the date they become effective.

1.2 Going concern
Introduction
In line with provision C1.3 of the 2014 UK Corporate Governance Code, the Directors are required to assess the prospects of the Bank with a particular focus on the 12 month period following the publication of the financial statements.

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

The assessment of the appropriateness of the going concern basis of accounting for the Bank's 2016 Annual Report has been subject to thorough consideration involving analysis and discussion by management, Executive and Board Committees and the Board, in line with our governance process and discussions with the Bank's regulators.

The Directors have assessed the going concern status using a framework focusing on the Bank's capital, liquidity, performance versus the Bank's Plan, continued regulatory support and other material issues.

For further context of this Going Concern statement, please refer to the Principal Risks and Uncertainties (the PRU) and Risk Management sections of the Financial Statements, together with the Viability Statement of the Financial Statements. All of the risks and uncertainties described therein are considered as qualifications to the Bank's prospects over the period of assessment described below.

Recent announcements
The Bank announced on 26 January 2017 that it expected its CET1 ratio to fall and remain below 10% over the medium term and that it was unlikely to meet its Individual Capital Guidance (ICG) over the planning period to 2020. The Bank continues to expect to meet its Pillar 1 capital requirements and to maintain sufficient liquidity to meet its obligations.

On 13 February 2017 the Bank announced that it was commencing a full sale process, inviting offers for 100% of its issued share capital and was also considering other options to build capital and meet the longer term capital requirements applicable to all UK banks.

The 2017-2021 Strategic Plan
The Bank undertakes an annual strategic planning process that produces a detailed five year strategic plan. The Bank has completed this annual exercise and now has a strategic plan covering the years 2017-2021 (the Plan). This exercise incorporates the underlying performance of the Bank in 2016 and considers various forward looking assumptions including the Bank's macroeconomic forecast, targeted new business volumes, operating expenses, project expenditure and credit risk projections.

Both management and the Board reviewed and challenged various iterations of the Plan during the latter part of 2016 and into Q1 2017. The review process focused on a number of changes in assumptions compared with those anticipated in the previous year's strategic planning process that have constrained the Bank's ability to generate organic capital, including the Bank of England base rate being lower and expected to remain so for longer than previously anticipated, higher than anticipated transformation and conduct remediation costs and the need to consider enhanced regulatory requirements including MREL[1]. The review and challenge of the Plan also considered upcoming wholesale funding activities including, but not limited to, the £400m of senior unsecured debt due for repayment in September 2017. In response to a currently non-binding communication by the Bank of England, the Board's view is that the likely level of required MREL cannot be satisfied without additional CET1 capital achieved via capital raising activities.

As an alternative to a sale, the Bank's Plan seeks to raise an additional £700m to £750m of CET1 resources. Whilst the structure, terms and timing are to be finalised, this may be achieved via a liability management exercise involving the potential exchange of the Bank's debt securities to equity (taking into account the Bank's creditor hierarchy) alongside an additional primary equity capital raise of approximately £300m to enable the Bank to achieve CET1 ICG compliance from 2017 onwards. Furthermore, assuming the successful completion of the capital raise, the Bank is anticipating circa £250m Tier 2 issuance during 2018 and further MREL qualifying debt issuances in 2020/21. If all of these measures are implemented as planned, the Bank expects to be fully ICG compliant from 2018 and meet all capital and interim MREL requirements in 2019. The Plan has been accepted by the PRA. The PRA has noted that neither a sale nor the capital raise can be guaranteed. In its communication to the Bank regarding their acceptance of the Plan the PRA also drew the Bank's attention to the following:

- A successful sale may depend, among other things, on greater certainty on the scale of the Bank's future pension obligations, and the PRA expects the Bank to seek to advance negotiations with The Co-operative Group and The Co-operative Group's defined benefit pension scheme (Pace) Trustee;
- The Bank's continuing high cost:income ratio, with the Bank expected to demonstrate to investors that it has the means and ability to deliver, in the medium term, an acceptable ratio; and
- The need for an orderly and well-governed process in order to minimise any destabilising effects of ongoing external communications.

The Bank will monitor its performance against the Plan, including the proposed management actions, and continue to engage with its regulators. The Bank notes that the PRA reserve the right to take further action in response to a material variance to the Plan, or to other material changes in circumstances.

Capital

Total CRD IV capital resources as at 31 December 2016 are £1.2bn (31 December 2015: £1.6bn) with Core Tier 1 capital after regulatory deductions of £0.7bn (31 December 2015: £1.2bn). The Bank's CET1 ratio stands at 11.0% (31 December 2015: 15.5%). As per the announcement on 26 January 2017 the Bank expected its CET1 ratio to fall and remain below 10% over the medium term whilst still expecting to meet its Pillar 1 capital requirements.

As at 31 December 2016, the Bank did not meet its ICG for total capital set by the PRA, a position the PRA has accepted as part of their acceptance of the Bank's Plan.

The Bank anticipates that if the capital raising actions within the Plan are successful along with the successful remediation of Capital Requirements Regulation non-compliance issues outlined below and approximately £250m of MREL eligible Tier 2 capital issuance in 2018 it will return to sustainable ICG compliance, be PRA buffer compliant by the end of the planning horizon; and have a leverage ratio which is sustainably above 3%. In addition, on the basis the capital raising is successful the Plan assumes the Bank can begin MREL debt issuances commencing in 2018 to ensure the Bank will be compliant with the Bank of England's transitionary MREL requirements as outlined in Policy Statement 30/16 published in November 2016[1].

Should the Bank of England require the Bank to issue MREL debt instruments in the amounts and at the time needed within the Bank of England's non-binding indication of a future requirement, the MREL debt may not be able to be issued on acceptable terms, or at all. Furthermore, the projected CET1 headroom to the Pillar 1 regulatory minimum is not considered to be sufficient to withstand the impact of the likely ongoing cost of such instruments. Further, if any other risks were to materialise to reduce the Bank's CET1 headroom the PRA or Bank of England could exercise their powers under the Banking Act of 2009. Without further CET1 issuance, the Bank does not expect to meet its ICG and PRA buffers before the end of the 2021 planning period.

The Bank continues to monitor the regulatory capital horizon for any emerging regulation that could impact its ability to deliver the Plan. This includes, but is not limited to, any updates with regards to the implementation of leverage ratio targets for the UK banking sector.

The Plan assumes the Bank will also seek to address the risks that are not captured in the Pillar 1 requirements under the ICG framework, that are currently part of its Pillar 2a capital requirements.

The Bank remains reliant on the continued support of the PRA regarding its present and future inability to meet regulatory capital requirements, including ICG, PRA buffer and to satisfy the non-binding indication of a future requirement and preferred timing of MREL debt issuance as indicated by the Bank of England and PRA.

Capital Requirements Regulation

The Bank is currently not compliant with the CRR provisions related to the use of an Internal Ratings Based (IRB) approach to modelling its credit risk capital requirements. A review by the PRA took place during 2015 and identified areas of non-compliance and inadequate procedures relating to use of an IRB approach, requiring improvement and a remediation plan to rectify under supervisory guidance. These areas include a redesign of model risk policy, redevelopment of the Bank's IRB models, and the strengthening of the overall control environment. In March 2016 the Bank received a formal communication from the PRA regarding the levying of an additional Pillar 2a requirement to cover these risks, and this remains within the Bank's Pillar 2a requirements confirmed as part of the Bank's revised ICG requirements communicated by the PRA in November 2016. This has been factored into the Plan. The Bank is progressing its remediation plan, as accepted by the PRA, in order to address these areas of non-compliance and currently expects them to be materially complete by the end of 2017.

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

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

The Bank remains reliant on the continued support of the PRA regarding its current non-compliance with CRR provisions and the execution of the Bank's remediation plan to return the Bank to compliance with CRR.

Liquidity
The Bank's liquid asset ratio at 31 December 2016 was 13.8% (31 December 2015: 15.6%).

As at 31 December 2016 the Bank had a significant surplus stock of high quality liquid assets to its regulatory Pillar 1 LCR and regulatory add-ons and a surplus to its internal liquidity risk appetite.

During the period to 31 December 2016, customer liabilities have fallen by £0.4bn which has in turn reduced the level of liquid assets the Bank held. The Bank continues to proactively manage its deposits, to match the funding requirements of the Bank's Assets. Period on period, there has been a reduction in deleverage activity within the Non-core Bank and an increase in Core Bank customer assets which has resulted in a level of high quality liquid asset holdings closer to that of the rest of the industry, and closer to the Bank's own liquidity risk appetite.

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

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

Through the remediation programmes, the Bank has built resilience into each component of its critical IT infrastructure, proving the Bank's ability to recover its critical services in the event of the failure of any individual component. The Bank believes that this component-level proof of recoverability, taken in aggregate, delivers a reasonable level of recoverability from a major IT infrastructure failure, e.g. the loss of a data centre.

The migration of the Bank's mainframe and associated midrange systems to an IBM managed environment completed in February 2017 has delivered a further step-change in the Bank's ability to test and demonstrate the recoverability of service. There will be further migrations during the next 12 months as the Bank completes its technology separation from The Co-operative Group.

The Bank has received confirmation from the FCA that they consider the breach of IT Threshold Conditions has been remediated and the Bank to be compliant with IT Threshold Conditions.

Risks and uncertainties
The key risks and uncertainties associated with the successful execution of the Plan include, but are not limited to:

1. The Board has announced a sale of the Bank, which may or may not proceed. The Plan approved by the Board and accepted by the PRA anticipates, various important management actions, including successfully raising between £700m and £750m of CET1 capital, sufficient to meet the CET1 component of the Bank's future ICG requirements. The sale and the management actions contained within the Plan carry significant execution risk and material uncertainty exists with regards to the eventual outcome. This includes the finalisation of any liability management exercise and other capital raising actions, obtaining necessary regulatory, shareholder and public debt holder approvals, the finalisation and execution of definitive documentation and prevailing market conditions. Accordingly there cannot be certainty that the proposed actions will be completed when planned or needed, on favourable terms, or at all;

2. The regulators' continued acceptance of the Bank's inability to meet regulatory requirements including CRR, ICG and PRA buffer compliance which will be subject to material uncertainty should the actions detailed in paragraph 1 above not be completed. To the extent this acceptance is withdrawn, or there is deterioration in the Bank's position versus the Plan, then the Bank's regulators have the discretion to exercise one or more of various powers over the Bank. They can agree a revised plan, require some other actions on the part of the Bank or, in the absence of ether of these, the Bank of England or PRA may vary or restrict the Bank's permissions or business, or impose a special resolution procedure on the Bank under the Banking Act;

3. The uncertainties surrounding whether or not a sale process or any capital raising will be implemented, and related press speculation about the Bank's future, may damage the Bank's brand and reputation, negatively impact our ability to attract and retain customers, colleagues and suppliers, and, therefore, may have an adverse effect on customer and investor confidence, the Bank's business, operating results and the Bank's ability to successfully deliver its strategy and related Plan;

4. If, in due course, the Bank is unable to issue the required amount of MREL debt instruments, the Bank of England and the PRA can agree to accept a revised issuance plan, use their respective powers to require some other remediating action on the part of the Bank, or in the absence of any of these the Bank of England may exercise its resolution powers under the Banking Act 2009. In considering going concern the Board has taken note of the contents of PRA consultation paper (CP 44/15);

5. 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 entire of the Pace Scheme's liabilities would need to be borne by the Bank. In addition, a material difference to current estimates of the funding of the pension scheme, or the Bank being forced to pay for a greater proportion than currently envisaged, could increase the Bank's Pillar 2a capital requirements or cause additional expense through increased contributions;

6. The Plan assumes the Bank is able to deliver the remaining transformation, remediation and change programmes and the cost reduction initiatives already underway without material deviation from planned timescales and costs. Any deficiencies in the appropriate governance and related programme management processes to assist with the satisfactory delivery would have an adverse effect on the Bank's financial position compared with that anticipated in the Plan; and

7. More generally, the further materialisation of particular challenges that are described in the Principal Risks and Uncertainties section and include, but are not limited to:
   - the Bank's ability to achieve the targeted cost savings;
   - its ability to retain customers and deposits and thus preserve the Bank's current market share over the life of the Plan;
   - the timing and quantum of impacts on capital from any asset reduction exercises within the Legacy Portfolio business;
   - the Bank meeting its targeted improvements in net interest margin;
   - the ability of the Bank to generate sufficient asset growth;
   - the ability to maintain the Bank's access at, an appropriate cost, to liquidity and funding to fund the required level of asset origination in the Plan including the ability to gain access to any current or future central bank initiatives;
   - a possible deterioration in the credit quality of the Bank's asset portfolio driven by an increase in arrears and non-performing loans;
   - the Bank's ability to deliver the complex transformation plan affecting its operations and systems without significant delay and within budget, failure to achieve either of which could have negative impacts on financial performance;
   - an adverse macroeconomic or political outcome negotiated as part of the UK leaving the EU;
   - unplanned or increased costs from, for example, existing or future (including any not yet known or fully assessed) conduct risk matters or regulatory investigations;
   - unforeseen regulatory change; and
   - realising the benefits of historic and future investment expenditure in Operational, Remediation and Strategic projects

Conclusion

Should the Bank successfully complete a sale of 100% of its ordinary share capital, the going concern status will be reliant on the acquirer ensuring that the Bank or company has sufficient resources to continue realising its assets and discharging its liabilities.

As outlined above there are significant execution risks in respect of the Bank being able to successfully complete a sale of the Bank or a Capital Raising on acceptable terms, when needed, or at all. After making enquiries of management and considering the Plan, the Board has concluded that the risks outlined above represent material uncertainties, which may cast significant doubt upon the Bank's ability to continue as a going concern. These enquiries and considerations have included contemplating the successful raising of new equity capital from existing and new providers, the potential liability management exercise, and the resulting projections of the income statement, balance sheet, capital and liquidity in the Plan. These enquiries and considerations have focused in particular on the 12 month period following the date of issuance of the Bank's financial statements.

Further, there are key risks and material uncertainties regarding the successful execution of the Plan. In the event that one or more of these key risks and material uncertainties were to materialise the Bank may be unable to continue realising its assets and discharging its liabilities in the normal course of business. The Bank also remains reliant on the continued acceptance of the PRA regarding its inability to meet CRR, including ICG and PRA buffer compliance, during and beyond the period of the going concern assessment.

The PRA has accepted the Plan and this combined with the liquidity position of the Bank and subject to the material risks and uncertainties outlined above, allows the Board to conclude that they have a reasonable expectation that the Bank will have adequate resources to continue in business for at least the next 12 months. Consequently the Bank has adopted the going concern basis in preparing these financial statements and the 2016 Annual Report and Accounts do not include the adjustments that would result if the Bank was unable to continue as a going concern.

Footnotes to Going Concern

1. PRA PS 30/16 'The minimum requirements for own funds and eligible liabilities (MREL) buffers and Threshold Conditions' was published on 8 November 2016 and sets out that PRA proposes to adopt a policy that if a firm is in breach of its MREL requirement, it would not automatically mean that the PRA will consider the firm is failing, or likely to fail, to satisfy Threshold Conditions (http://www.bankofengland.co.uk/financialstability/Documents/resolution/mrelpolicy2016.pdf).

1.3 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.

1.3.1 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 by 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.

1.3.2 Basis of consolidation

a) Subsidiaries

Subsidiaries are all entities (including structured entities) controlled by the Company. Control exists whenever the Company is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity, in accordance with the requirements of IFRS 10 (Consolidated financial statements). In assessing control, potential voting rights that presently are exercisable are taken into account. The financial information of subsidiaries is included in the consolidated financial information from the date that control commences until the date that control ceases.

When the Company ceases to have control, any retained interest in the entity is remeasured to its fair value at the date control is lost, with the change in carrying amount recognised in the profit or loss. The fair value is the initial carrying amount for the purposes of subsequently accounting for retained interest as a financial asset. In addition, any amounts previously recognised in other comprehensive income in respect of that entity are accounted for as if the Group had directly disposed of the related assets or liabilities. This may mean that amounts previously recognised in other comprehensive income are reclassified to profit or loss.

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 Partnership 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 under IFRS 10 considerations, 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 assessment of whether the Company has control over an SPE is carried out at inception. A reassessment of whether the Company has control over an SPE is performed at the end of each period.

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 ventures. 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 determines, with due regard to the variable returns from the structured entity and the Bank's ability to affect those returns, that it does not control the structured entity under IFRS 10 (Consolidated financial statements) considerations. 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 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.

1.3.3 Revenue recognition
a) Interest income and expense
Interest income and expense is recognised on an effective interest rate (EIR) basis, inclusive of directly attributable origination and incremental transaction costs and fees including arrangement and broker fees, valuation and solicitor costs, discounts and premiums where appropriate.

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 incurred credit losses.

When an instrument is impaired, the Bank reduces the carrying amount, based on the revised cash flows, discounted at the original EIR of the instrument, and continues unwinding the discount as interest income.

Early redemption charges are recognised on a cash basis as received, as it is not possible to reliably estimate the receipt of such fees.

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 EIR calculation.

Commitment fees received are deferred and included in the EIR calculation upon completion or taken in full at the date the commitment period expires and completion does not occur.

All other fee and commission income, such as loan closure fees or arrears fees, not included in the EIR 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.

c) Dividend income
Dividend income is recognised when the Bank's right to receive the payment is established, which is generally when the shareholders approve the dividend as final. Interim dividends are recognised when the dividend is paid.

1.3.4 Financial instruments (excluding derivatives)
a) Recognition
Financial assets are recognised in the Bank's balance sheet when the Bank becomes party to the contractual provisions of the instrument. 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.

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. If the Bank neither transfers nor retains substantially all the risks and rewards of ownership and continues to control the transferred asset, the Bank recognises its retained interest in the asset and an associated liability for amounts it may have to pay. A substantial modification of the terms of an existing financial liability or a part of it (whether or not attributable to the financial difficulty of the debtor) is accounted for as an extinguishment of the original financial liability and a recognition of a new financial liability.

When a financial asset is derecognised in its entirety, the difference between the carrying amount and the sum of the consideration received (including any new asset obtained less any new liability assumed) is recognised in the income statement.

When available for sale financial assets are derecognised, the cumulative gain or loss, including that previously recognised in other comprehensive income, is recognised in the income statement.

A financial liability is derecognised when the obligation is discharged, cancelled or expires. Any difference between the carrying amount of a financial liability derecognised and the consideration paid is recognised through the income statement.

c) Financial assets

i. Overview

The Bank classifies its financial assets (excluding derivatives) as:

- loans and receivables;
- available for sale; or
- financial assets at fair value through profit or loss.

ii. Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market and 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 EIR method. The amortised cost is the amount advanced less principal repayments, plus the cumulative amortisation using the EIR method of any difference between the amount advanced and the maturity amount less impairment provisions for incurred losses.

Loans and receivables mainly comprise loans and advances to banks and customers (except where the Bank has elected to carry the loans and advances to customers at fair value through profit or loss as described in accounting policy 4.c) iv. 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 quoted in an active market and not accounted for at fair value through profit or loss. These are initially recognised on their trade date, measured at fair value based on current bid prices where quoted in an active market. Where the debt securities and equity shares are unlisted the fair values are based on valuation techniques including discounted cash flow analysis, with reference to relevant market rates, and other commonly used valuation techniques. Movements in fair value are recorded in equity as they occur. On disposal, gains and losses recognised previously in equity are transferred to the income statement. In exceptional circumstances, for instance where the market in the securities has become inactive, these are reclassified 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.

iv. Financial assets at fair value through profit or loss

Financial assets designated at fair value are assets which have been designated to eliminate or significantly reduce a measurement inconsistency or where management specifically manages an asset or liability on that basis, e.g. 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 other operating income as they arise.

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. Derivative financial liabilities are subsequently remeasured to their fair value at each balance sheet date. The resulting gain or loss is recognised in the income statement immediately unless the derivative is designated and effective as a hedging instrument in a cash flow hedge. See ‘Derivative financial instruments and hedge accounting’ policy for more detail.

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.

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, eliminating potential 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, being 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 estimated life of the liability 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.

1.3.5 Impairment provisions
a) Assessment
i. Objective evidence
At the balance sheet date, the Bank assesses whether there is objective evidence that a financial asset or group of financial assets, not held at FVTPL, is impaired. Impairment losses are incurred only if there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition and before the balance sheet date (a 'loss event') which has an impact on the estimated future cash flows of the financial asset that can be reliably estimated.

Objective evidence that financial assets are impaired can include significant financial difficulty of the borrower, a breach of contract, such as default or delinquency in interest or principal payments, the granting 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 161.

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.

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, or which do, but are not found to be impaired, are collectively assessed for impairment (incurred but not yet reported) by grouping together loans and advances with similar risk characteristics.

ii. Collective accounts
a) Retail
When assessing collective impairment for secured retail loans, the Bank estimates a shortfall based on the difference between the current loan balance and the expected 'forced sale' price of collateral, discounted at the effective interest rate of the loan to reflect the anticipated time to sale, and taking into account anticipated fees and costs prior to sale. The shortfall is multiplied by the probability the loan will default and further multiplied by the probability that the loan will be taken into possession to determine the impairment required.

When assessing collective impairment for unsecured retail loans, the Bank estimates losses on loans via a two stage approach, which determines probability of default (PD) and loss given default (LGD) to generate provision rates which are applied to the current balance sheet, including loans transferred to debt collection agencies. Once impaired, accounts are subjected to higher levels of impairment according to both their relevant stage of delinquency, i.e. the number of days in arrears, and their consequent likelihood of ultimately being charged off. Default rates, loss rates and future recoveries are regularly benchmarked against actual outcomes to ensure that they remain appropriate.

Impairment stock determined by provision models is augmented where it is judged that the best estimate of losses are likely to differ from those suggested by historical trends. Impairment determined both via provision models and management overlays are reviewed by the Impairment Adequacy Forum.

b) Corporate
Collective provision is held for all Corporate exposures, apart from customers in default for which specific provision has been raised. Collective provision is determined by multiplying the drawn balance of the loan by the following default estimates:

i) the probability that, during the emergence period, balances will move to default; or
ii) the probability that, during the emergence period, balances will move to impaired; and
iii) the probability that, during the outcome period, balances will move from impaired to default.

The resulting balance is multiplied by the proportion of newly defaulted balances that ultimately move to an unrecoverable LGD.

The loss emergence period is defined as the time between a loss event occurring and it being evidenced. For Corporate loans the emergence period is six months and is reviewed annually. For all commercial real estate loans where the indexed loan-to-value (LTV) is greater than 100% and to those loans which are due to contractually expire in the next 36 months and the indexed LTV is greater than 65% the probability of emerging to impaired (Pe(i)) parameter is set to 100%. All other PD components are based on recently observed loan migration experience. Loans which are on watchlist are impaired and therefore (Pe(i)) is set to 100%.

c) Measurement
The amount of the loss is the difference between:

- the asset's carrying amount; and
- the present value of estimated future cash flows (discounted at the asset's original EIR for amortised cost assets and at the current market rate for available for sale assets).

Where the debt is secured, the assessment reflects the expected cash flows from the realisation of the security, net of cost to realise, whether or not foreclosure or realisation of the collateral is probable.

d) Impairment of financial assets carried at amortised cost
The amount of the impairment loss on assets carried at amortised cost is recognised immediately through the income statement and a corresponding reduction in the value of the financial asset is recognised through the use of an allowance account.

A write off is made when all or part of a claim is deemed uncollectable or forgiven after all the possible collection procedures have been completed and the amount of loss has been determined. Write offs are charged against previously established provisions for impairment or directly to the income statement.

Any additional recoveries from borrowers, counterparties or other third parties made in future periods are offset against the write off charge in the income statement once they are received.

Provisions are released at the point at which it is deemed that, following a subsequent event, the risk of loss has reduced to the extent that a provision is no longer required.

e) Impairment of financial assets classified as available for sale
Available for sale assets are assessed at each balance sheet date to see whether there is objective evidence of impairment. In such cases, any impairment losses are recognised by transferring the cumulative loss that has been recognised directly in equity to profit or loss.

When a subsequent event causes the amount of impaired loss on available for sale investment securities to decrease, and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed through the income statement.

However, any further recovery in the fair value of an impaired available for sale equity security is recognised directly in equity.

1.3.6 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.

1.3.7 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 18. 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 remeasurement 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 economic 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 also formally documents its assessment, both at the inception of the hedge relationship as well as on an ongoing basis, as to whether the hedging instruments are expected to be 'highly effective' in offsetting the changes in fair value or cash flows of the respective hedged items during the period for which the hedge is designated, and whether the actual offset in changes in fair value in each hedge are within a range of 80% to 125%.

i. Cash flow hedges
Where derivatives are designated as hedges of the exposure to variability in cash flows of a recognised asset or liability, or a highly probable forecast transaction, the portion of the fair value gain or loss on the derivative that is determined to be an effective hedge is recognised directly in equity. The ineffective part of any gain or loss is recognised in the income statement immediately.

The accumulated gains and losses recognised in equity are reclassified to the income statement in the periods in which the hedged item will affect profit or loss. When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss recognised at that time remains in equity until the forecast transaction is eventually recognised in the income statement.

When a forecast transaction is no longer expected to occur, the cumulative gain or loss that was recognised in equity is immediately reclassified to the income statement.

ii. Fair value hedges
Where a derivative is designated as the hedging instrument to hedge the change in fair value of a recognised asset or liability or a firm commitment that could affect profit or loss, changes in the value of the derivative are recognised immediately in the income statement together with changes in the fair value of the hedged item that are attributable to the hedged risk.

Fair values are based on quoted market prices in active markets or, where these are not available, using valuation techniques such as discounted cash flow models. If the derivative expires or is sold, terminated, or exercised, or no longer meets the criteria for fair value hedge accounting, or the designation is revoked, then hedge accounting is prospectively discontinued. Any adjustment up to that point, to a hedged item for which the EIR method is used, is amortised to profit or loss as part of the recalculated EIR of the item over its remaining life.

iii. Fair value hedge accounting for a portfolio hedge of interest rate risk
As part of 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 percentage 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 for the hedged risk 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 on an appropriate basis.

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.

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 profit or loss), the embedded derivative is separated from the host and held on-balance sheet at fair value. Movements in fair value are recognised in the income statement, whilst the host contract is accounted for according to the relevant accounting policy for that particular asset or liability.

1.3.8 Property, plant and equipment
The Bank recognises assets where it is exposed substantially to all the risks and rewards of those assets.

Items of property, plant and equipment are stated at cost less any accumulated depreciation and impairment losses. Depreciation is recognised on a straight line basis at the following default rates, which are estimated to reduce the assets to their realisable values at the end of their useful lives.

Long leasehold land and buildings	40 years
Freehold and leasehold improvements	10 years
Short leasehold buildings	life of lease
Equipment:	
Computer	5 years
Furniture and equipment	7 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 greater than the recoverable amount, the shortfall is recognised in the income statement.
Gains and losses on disposal of an item of property, plant and equipment are determined by comparing the proceeds from disposal, less costs to sell, with the carrying amount and are recognised net within operating expenses in the income statement.

1.3.9 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 acquired computer software together with the costs of internal 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. Costs are capitalised only if the asset can be reliably measured, will generate future economic benefits, the completion of the asset is feasible, there is an intention to complete the asset, an intention and ability to use the asset, and costs attributable to the asset are able to be reliably measured. 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. Once the asset is available for use 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. A review of the asset's useful life is carried out and a maximum useful life of up to 10 years is applied.

c) Impairment
Intangible assets are assessed for indications of impairment at least annually. If impairment indicators are discovered, 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, the shortfall is recognised as a charge to 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.

1.3.10 Business combinations
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.

1.3.11 Leases

a) Overview

The Bank enters into leases for land and buildings, finance leases for software 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.

c) Assets leased from third parties

i. Finance leases

The amount to be recognised as a finance lease is calculated on inception of the lease. Finance lease assets are capitalised at commencement of the lease (being the date at which the Bank is able to exercise its right to use the asset) at the lower of fair value of the leased asset and the present value of the minimum future lease payments, and subsequently in accordance with the relevant policy for the underlying asset. An equal liability is recorded in other liabilities. The interest element of the finance charge is allocated to the lease payments so as to record a constant periodic rate of charge on the outstanding liability.

ii. Operating leases

Operating lease payments are charged to the income statement on a straight line basis over the term of the lease and the asset is not recognised on the balance sheet.

1.3.12 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. The Bank accounts for all investment properties using the fair value method. 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 investment 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. Prior to such a transfer the property is measured at fair value with any gain or loss recognised in the income statement. 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.

1.3.13 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.

1.3.14 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 The Co-operative Group 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 Plan.

Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

1.3.15 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 closed defined benefit section and a defined contribution section. There is currently insufficient information available to consistently and reliably identify the Bank's share of its liabilities in respect of this multi-employer scheme. For this reason 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 33 for further details.

b) Britannia Pension Scheme
The Britannia scheme is a defined benefit scheme. On the 23 December 2015, a Flexible Apportionment Arrangement (FAA) was executed, at which time the Co-operative Bank plc was named as a participating employer and replaced Co-operative Financial Services Management Services (CFSMS - a Co-operative Group subsidiary) as the principal employer, following which, CFSMS, Western Mortgage Services (WMS) and Platform Home Loans (PHL) departed from the scheme with their share of the scheme's liabilities being transferred to the Bank. As the Bank had already been recognising the total assets and liabilities of the scheme on its balance sheet, due to a guarantee it provided, the FAA has not had a significant new impact on the Bank's exposure to the risks of the scheme. See note 33 for further details.

Accordingly, the Bank recognises the fair value of the scheme assets less the present value of the scheme's estimated obligations. In addition, the Bank recognises as a liability the present value of irrecoverable minimum funding requirements. The defined benefit obligation is calculated annually by independent actuaries using the projected unit credit method. The present value of the defined benefit obligation is determined by discounting the estimated future cash outflows using interest rates on high quality corporate bonds.

Actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions are charged or credited to equity in other comprehensive income in the period in which they arise. Past service costs are recognised immediately in income. Actuarial gains are only recognised to the point where any previously recognised liability is reversed.

1.3.16 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 prevailing at that date. Foreign currency differences arising on translation are recognised in the income statement, except for foreign currency differences arising on translation of 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.

1.3.17 Investments in subsidiaries and Group undertakings
Investments in subsidiaries are initially measured at fair value which equates to cost and subsequently valued at cost less impairment.

1.3.18 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 an appropriate pre-tax rate, if the expected future cash flows can be reliably estimated.

In the case of restructuring provisions, a constructive obligation arises when a plan is sufficiently detailed and is formalised. Restructuring provisions include only direct expenditure arising from the restructuring plan which is both necessary for restructuring and not associated with the Bank's ongoing activities.

1.3.19 Share premium
Share premium is the amount by which the fair value of the consideration received exceeds the nominal value of shares issued. Expenses and commissions paid on the issue of shares are written off against the share premium of the same issue.

1.3.20 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.

1.3.21 Share-based payments

For cash settled share-based payments, a liability is recognised for the goods or services acquired, measured initially at the fair value of the liability at the grant date. The fair value excludes the effect of non-market based vesting conditions. At each balance sheet date until the liability is settled, and at the date of settlement, the fair value of the liability is remeasured, with any changes in fair value recognised in the profit or loss for the year. Details regarding the determination of the fair value of cash settled share-based transactions are set out in note 39.

Cash settled share-based payments are expensed on a straight line basis over the vesting period, based on the Bank's estimate of awards that will eventually vest, and adjusted each year for the change in fair value. The vesting period is the period over which all specified vesting conditions are to be satisfied. At each balance sheet date, the Bank revises its estimate of the number of awards expected to vest as a result of the effect of non-market based vesting conditions. The impact of the revision of the original estimates, if any, is recognised in the profit or loss such that the cumulative expense reflects the revised estimate, with a corresponding adjustment to the liability.

2. Critical judgements and estimates

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

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

The judgements and assumptions that are considered to be the most important to the portrayal of the Bank's financial condition for the year ended 31 December 2016 are those relating to loan impairment provisions, conduct risk provisions, deferred tax, pensions, separation provision, effective interest rates (EIR) and fair value adjustments and group relief receivable.

2.1 Loan impairment provisions

2.1.1 Overview

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

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

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

The methodology for loan impairment for both Core (unsecured and secured residential and BaCB) and Non-core (Legacy Portfolio and Optimum) segments is explained on pages 161 and 162 of the Annual Report and Accounts for the year ended 31 December 2016. In 2016, enhancements to the interest only methodology, affecting Core secured and Optimum portfolios, have been made to incorporate customer repayment vehicle data and more appropriate forced sale discount (FSD) and PPD parameters.

2.1.2 Collective provisions

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

a) Core

i) Unsecured and secured residential

The Bank's collective provision for unsecured and secured retail personal advances is £61.3m (31 December 2015: £101.5m). All 2015 provisions are now shown as collective for unsecured and secured retail personal advances.

A key estimate within the unsecured models is the probability that impaired accounts move to a default status during the outcome period. The model uses historical actual data over a defined period of time to arrive at an average probability of accounts moving to default. If the maximum probability of default (PD) had been used for each category of arrears and for each product, this would increase the collective provision by £3.6m for all of the unsecured portfolios.

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

A key estimate is the collateral value. A 10% decrease to the indexed collateral used in the model would increase the provision across the secured portfolios, excluding Optimum, by £1.1m.

ii) BaCB

The Bank's collective provision against corporate loans in the Core division has decreased to £0.5m (31 December 2015: £0.8m). A key estimate is the collateral value. A 10% decrease to the indexed collateral used in the model would increase the provision by 14% to £0.6m. The impact of increasing model default rates is not significant, an increase in PD of 10% results in a 2.3% increase in collective provision.

b) Non-core

i) Legacy Portfolio
The Bank's collective provision against Legacy Portfolio loans in the Non-core division has decreased to £1.3m (31 December 2015: £7.5m) driven largely by deleverage of performing assets. A key estimate is the collateral value. A 10% decrease to the indexed collateral used in the model would increase the provision by 14% to £1.6m. The impact of increasing model default rates is not significant, an increase in PD of 10% results in a 1.6% increase in collective provision.

ii) Optimum collective
In addition to the above, collective provisions of £12.5m (31 December 2015: £3.3m) are held in the Optimum segment of the Non-core business. All 2015 provisions are now shown as collective for Optimum.

A key estimate of the secured impairment model provisioning is forced sale discount. The forced sale discount is an average and is calculated using historical actual data over a defined outcome period. If the maximum forced sales discount for the outcome period was used to calculate the provision it would increase by £0.8m.

A key estimate is the collateral value. A 10% decrease to the indexed collateral values used in the model would increase the provision by £6.1m.

2.1.3 Individual provisions
Individual provisions are recorded for loans which are assessed for impairment on an individual basis. Loans considered as individually significant are typically Legacy Portfolio and BaCB loans.

a) Core

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

b) Non-core

Legacy Portfolio
The Bank's individual impairment provision on Legacy Portfolio loans totals £46.2m (31 December 2015: £118.4m). The provision has decreased reflecting the Bank's strategic deleveraging of Non-core assets.

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

2.2 Conduct risk provisions

2.2.1 Overview
The conduct and legal risks provision involves significant judgement and therefore constitutes one of the Bank's critical accounting estimates.

Significant components of the conduct risk and legal provision are potential customer redress in relation to Payment Protection Insurance (PPI), breaches of the technical requirements of the Consumer Credit Act (CCA). The Bank has also made provision for conduct issues requiring redress which are individually less significant.

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

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

2.2.2 Payment Protection Insurance (PPI)
A provision of £90.4m (31 December 2015: £87.0m) has been recorded in respect of potential customer redress relating to past sales of PPI. The provision is in respect of the total expected cost of carrying out this work and paying compensation, making total provisions raised to date of £459.8m (31 December 2015: £423.8m).

Overall complaint redress performance in the year to 31 December 2016 has been slightly better than expected. The £36.0m charge in 2016 has been recognised to reflect the Bank's year end estimates of the impact of both the FCA Consultation Paper CP16/20 and the FCA Consultation Paper CP16/20 and the FCA announcement on 2 March 2017 that the time bar will end on 29 August 2019.

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

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

Description of estimate	Current position	Future expected	Sensitivity on current position
Number of inbound valid[1] complaints	101k	29k	1,000 = £2.5m
Proactive Mailings	45k	0k	1,000 = £1.8m
Response rate to proactive mailings	60%	0%	-
Average uphold rate per valid[1] complaint	63%	72%	1% = £0.9m
Average redress per upheld complaint[2]	£3,490	£2,877	£100 = £2.1m

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

The Bank has assumed that the FCA time bar comes into force on 31 December 2019 which is a further increase of 6 months on the Bank's assumption at 30 June 2016. Based on our current assumptions each month change in the time bar date would cost £1.9m in customer redress and delivery costs to deal with the additional complaints received.

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.

2.2.3 Other conduct/compliance related provisions
Key assumptions include basis of redress, operating costs of resolving redress, level of complaints, uphold rates, proactive contact and response rates and Financial Ombudsman Service referral and uphold rates.

2.3 Deferred tax
The Bank has a deferred tax asset of £nil (31 December 2015: £7.6m) and a deferred tax liability of £14.2m (31 December 2015: £47.8m).

Where it is permissible to do so, the Bank has recognised deferred tax assets to offset against deferred tax liabilities. The Bank has recognised deferred tax assets of £37.1m (31 December 2015: £20.4m) on this basis. The Bank has not recognised any other deferred tax assets in respect of trading losses or other temporary differences dependent on the future performance of the Bank as doubt exists over the availability of sufficient future taxable profits.

The UK corporation tax will reduce from 20% to 19% (effective from 1 April 2017) and then to 17% (effective from 1 April 2020); the latter rate change was enacted on 15 September 2016. A banking surcharge tax of 8% also applies to the Bank (effective from 1 January 2016). Deferred tax has been calculated by reference to the most appropriate rate based on forecasts.

For further information on the accounting treatment of deferred tax and future rates of corporation tax can be found on pages 165 to 166 in the Annual Report and Accounts for the year ended 31 December 2016.

2.4 Pensions

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

2.4.2 Defined benefit accounting for the Britannia scheme
The Bank also participates in the Britannia Pension Scheme, which is a closed defined benefit scheme. Following consultation with the Trustee and legal advisors, changes were effected to the scheme whereby the Bank is now deemed to have a right to a refund of any surplus in the scheme, and as such has recognised the full IAS 19 surplus on its balance sheet as at 31 December 2016, in line with IFRIC 14.

Sensitivities to the defined benefit obligations are shown in note 33.

2.5 Separation provision
A provision of £27.3m (31 December 2015: £64.3m) is held against separation costs directly relating to the Bank's obligation to separate from The Co-operative Group.

A possible change in overall estimates of costs for key separation provision judgements, relating to both the rates paid for resources and time taken to complete the programme, could increase the provision by £1.4m.

Further detail can be found in note 31.

2.6 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, a 0.5% increase in the assumed standard variable rate in place after the expiry of the fixed rate period for all products would result in a £11.0m (22.8%) increase in the EIR adjustment required to the loans and advances to customers balance as at 31 December 2016.

On the merger of the Bank and Britannia Building Society in August 2009, an exercise was undertaken to fair value the respective assets and liabilities of Britannia Building Society. These fair value adjustments are unwound on an EIR basis over the effective lives of the assets and liabilities. 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 assumed call date of the underlying Leek debt securities. As a measure of the sensitivity of the remaining lives on these instruments, if the Leek notes were to be redeemed one month earlier than the assumed call date, the Leek notes fair value adjustment would decrease by £9.5m (16.2%) as at 31 December 2016, resulting in additional expense of £9.5m in the year to 31 December 2016.

2.7 Group relief receivable

As part of the negotiations relating to the separation of the Bank from The Co-operative Group, the Bank and The Co-operative Group agreed terms relating to the surrender of group relief between the entities in the Bank's tax group and entities in The Co-operative Group tax group. A deed sets out the basis of the agreement by The Co-operative Group to take proactive steps to allow it to maximise its claim for tax losses from the Bank for the accounting periods to 31 December 2012 and 31 December 2013. The deed also addresses the terms of the payment by The Co-operative Group to the Bank for those tax losses. The 2016 consolidated financial statements, which include a group relief receivable of £84.1m (31 December 2015: £60.1m), have been prepared on a basis consistent with the deed.

The Bank receives payment from The Co-operative Group when The Co-operative Group realises the benefit of the losses surrendered and at the corporation tax rate at which the benefit is realised. The value of the asset is sensitive to a number of assumptions including the forecast repayments provided by The Co-operative Group for the periods to 2019; The Co-operative Group's capital expenditure qualifying for capital allowances in future periods; The Co-operative Group's taxable profits in future periods; the Bank's extrapolation of the forecast repayments for the periods after 2019; changes in tax legislation, including the rate of corporation tax and the rates at which capital allowances on qualifying capital expenditure are available; and The Co-operative Group's capacity to claim the tax losses. If The Co-operative Group's capacity to realise benefit in 2016-2019 from the previously surrendered losses decreases by 5%, the value of the group relief receivable decreases by £6.0m.

3. Segmental information

The Bank was managed as two divisions during the current and prior year, 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 included activities not aligned with the current strategy of the Bank which are targeted for run down or exit. As of January 2017, the Bank no longer manages its operations as two separate functions.

Revenues are attributed to the segment in which they are generated.

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

The table below represents how the Bank reports its management accounts, as presented in the Detailed Financial Review.

	Core					Non-core			
	Retail	**BaCB**	**Treasury**	**Other[1]**	**Total Core**	**Legacy Portfolio**	**Optimum**	**Total Non-core**	**Total**
2016									
Net interest income/(expense)	**344.8**	**50.6**	**8.5**	**8.8**	**412.7**	**(1.1)**	**(16.8)**	**(17.9)**	**394.8**
Gains/(losses) on asset sales	**-**	**-**	**0.5**	**-**	**0.5**	**(14.0)**	**-**	**(14.0)**	**(13.5)**
Non-interest income	**28.0**	**12.7**	**10.6**	**5.9**	**57.2**	**8.4**	**1.1**	**9.5**	**66.7**
Operating income	**372.8**	**63.3**	**19.6**	**14.7**	**470.4**	**(6.7)**	**(15.7)**	**(22.4)**	**448.0**
Direct costs	**(114.1)**	**(6.1)**	**(6.2)**	**-**	**(126.4)**	**(6.9)**	**(2.5)**	**(9.4)**	**(135.8)**
Impairment (losses)/gains on loans and advances	**(0.6)**	**0.3**	**-**	**0.2**	**(0.1)**	**(1.1)**	**(1.1)**	**(2.2)**	**(2.3)**
Contribution result	**258.1**	**57.5**	**13.4**	**14.9**	**343.9**	**(14.7)**	**(19.3)**	**(34.0)**	**309.9**
Operations and Head office overheads									**(309.0)**
Operational projects									**(33.9)**
Operating result									**(33.0)**
Remediation projects									**(141.3)**
Strategic projects									**(134.3)**
Severance									**(21.5)**
Sale of Visa Europe share									**58.1**
Share of post-tax profits from joint ventures									**0.3**
Conduct and legal risk									**(24.9)**
Fair value amortisation									**(180.5)**
Loss before taxation									**(477.1)**
Income tax									**58.4**
Loss for the financial year									**(418.7)**

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

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

The table below represents how the Bank reports its management accounts, as presented in the Detailed Financial Review.

	Core					Non-core			
	Retail	BaCB	Treasury	Other[1]	Total Core	Legacy Portfolio	Optimum	Total Non-core	Total
Re-presented 2015									
Net interest income	401.7	41.9	14.2	2.8	460.6	1.6	9.3	10.9	471.5
Gains/(losses) on asset sales	-	-	(0.1)	(0.7)	(0.8)	(67.5)	(53.1)	(120.6)	(121.4)
Non-interest income/(expense)	43.2	11.6	(6.4)	4.0	52.4	14.0	3.5	17.5	69.9
Operating income	444.9	53.5	7.7	6.1	512.2	(51.9)	(40.3)	(92.2)	420.0
Direct costs	(116.0)	(9.3)	(7.4)	(10.4)	(143.1)	(9.9)	(4.9)	(14.8)	(157.9)
Impairment gains/(losses) on loans and advances	(3.7)	1.3	--	2.1	(0.3)	37.9	11.0	48.9	48.6
Contribution result	325.2	45.5	0.3	(2.2)	368.8	(23.9)	(34.2)	(58.1)	310.7
Operations and Head office overheads									(334.0)
Operational projects									(49.7)
Operating result									(73.0)
Remediation projects									(124.5)
Strategic projects									(91.7)
Severance									(8.0)
Sale of Visa Europe share									-
Share of post-tax profits from joint ventures									0.7
Conduct and legal risk									(193.7)
Fair value amortisation									(120.4)
Loss before taxation									(610.6)
Income tax									(12.2)
Loss for the period									(622.8)

1. Included within 'Core Other' is Unity Trust Bank (UTB). UTB, disposed on 14 December 2015, operated in the corporate banking and social economy sectors on behalf of trade unions and was consolidated into the Bank's 2015 results until the date of disposal.

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

The table below represents the reconciliation of the management account presentation in the Detailed Financial Review and the segmental note back to the Bank income statement.

	2016	Re-presented 2015
Net interest income		
Net interest income per Detailed Financial Review	**394.8**	471.5
Gains on asset sales	**-**	1.0
Interest fair value unwind	**(172.2)**	(115.0)
Provision for conduct risk	**(2.3)**	(58.3)
Net interest income	**220.3**	299.2
Non-interest income		
Non-interest income per Detailed Financial Review	**66.7**	69.9
Losses on asset sales	**(23.1)**	(128.4)
Sale of Visa Europe shares	**58.1**	-
Non-interest income	**101.7**	(58.5)
Comprising:		
Net fee and commission income	**40.9**	71.8
Income from investments	**0.2**	-
Other operating income/(expense)	**60.6**	(130.3)
	101.7	(58.5)
Operating expenses		
Total direct costs per Detailed Financial Review	**(135.8)**	(157.9)
Operations and Head office overheads per Detailed Financial Review	**(309.0)**	(334.0)
Projects and severance costs per Detailed Financial Review	**(331.0)**	(273.9)
Interest fair value unwind	**(7.2)**	(5.4)
Gains/losses on asset sales	**-**	6.0
Provision for customer redress	**-**	(0.5)
Provision for legal charges	**(0.2)**	-
Operating expenses	**(783.2)**	(765.7)
Provision for customer redress		
Conduct and legal risk per Detailed Financial Review	**(24.9)**	(193.7)
Provision for conduct risk included within interest income	**2.3**	58.3
Provision for customer redress included within operating expenses	**-**	0.5
Provision for legal charges included within operating expenses	**0.2**	-
Provision for customer redress	**(22.4)**	(134.9)
Interest fair value unwind		
Fair value amortisation per Detailed Financial Review	**(180.5)**	(120.4)
Interest margin unwind	**172.2**	115.0
Impairment unwind	**1.1**	-
Operating expenses unwind	**7.2**	5.4
Interest fair value unwind	**-**	-
Impairment gains on loans and advances		
Impairment (losses)/gains on loans and advances per Detailed Financial Review	**(2.3)**	48.6
Impairment unwind	**(1.1)**	-
Losses on asset sales	**9.6**	-
Impairment gains on loans and advances	**6.2**	48.6

There are three re-presentations to certain segmented allocations included within the 2015 Annual Report and Accounts.

1. £20.0m net interest income from Retail to Treasury relating to the liquidity transfer pricing generated from the Bank's free reserves (equity).
2. £22.0m of costs associated with the property and estates functions has been re-presented in Operations and Head Office overheads from Retail direct costs.
3. £8m of costs associated with the costs of implementing the Bank's revised target operating model, reported separately from strategic project expenditure.

Core Balance Sheet re-presentations and impact on prior year net interest margin (NIM)

The Bank has re-presented £0.5bn of assets from unallocated to Core Bank at 31 December 2015 which has reduced the 2015 Core Bank NIM to 1.89%.

The Bank has re-presented the 2015 balance sheet. This is driven by a reallocation of £0.5bn of previously unallocated assets and £1.0bn of previously unallocated liabilities across the Core and Non-core Business segments.

The table below represents segmental analysis of assets and liabilities on a management accounts basis as presented in the Detailed Financial Review.

	Core					Non-core			
2016	**Retail**	**BaCB**	**Treasury**	**Other**	**Total Core**	**Legacy Portfolio**	**Optimum**	**Total Non-core**	**Total**
Segment assets	**14,844.6**	**434.9**	**7,794.1**	**97.8**	**23,171.4**	**1,471.4**	**2,838.4**	**4,309.8**	**27,481.2**
Unallocated assets									**107.1**
Bank total assets									**27,588.3**

	Core					Non-core			
2016	**Retail**	**BaCB**	**Treasury**	**Other**	**Total Core**	**Legacy Portfolio**	**Optimum**	**Total Non-core**	**Total**
Segment liabilities	**19,405.1**	**2,719.3**	**3,741.1**	**251.2**	**26,116.7**	**61.3**	**-**	**61.3**	**26,178.0**
Unallocated liabilities									**451.8**
Bank total liabilities									**26,629.8**

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

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

As disclosed in the 2016 Interim report, £0.4bn of Private Finance Initiative, Renewable Energy and Asset Finance assets were transferred from Legacy Portfolio into BaCB as a result of a re-assessment of the credit quality of the loans, the blended return on capital of the portfolios and the alignment to the Bank's ethical Policy.

Following further management review of the go forward SME Banking strategy in H2 2016, BaCB will focus on developing a business banking proposition for small businesses, delivering simple solutions for the needs of small business customers mainly focused around savings and current accounts. As a result of this review the PFI and REAF assets transferred back to the Legacy portfolio in H2 2016 and are included within the Legacy Portfolio at the reporting date.

These assets contributed £4.6m of BaCB interest income in 2016.

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

4. Auditors' Remuneration

Prior year comparatives have been re-presented to attribute fees of £814,000, billed in 2016, to the 2015 financial year to which these fees relate, and to include audit expenses.

	2016 **£'000**	Re-presented 2015 £'000
Fees payable to the Bank's auditor for the audit of the annual accounts	**3,115**	2,000
Audit expenses	**250**	505
Audit fees billed in 2016 relating to the 2015 audit	**-**	814
Fees payable to the Bank's auditor for other services:		
Audit of the accounts of subsidiaries	**125**	300
Audit-related assurance services	**160**	200
Other assurance services	**40**	40
Total audit fees and expenses for the financial year	**3,690**	3,859
All other services provided by the auditor	**40**	53
Total auditor remuneration	**3,730**	3,912

5. Directors' emoluments

	2016 **£'000s**	2015 £'000s
Executive Directors	**4,172**	4,783
Non-Executive Directors	**1,052**	910
Total Directors' emoluments	**5,224**	5,693

No retirement benefits are accruing to Directors under defined benefit schemes.

The aggregate of emoluments and amounts receivable under incentive schemes of the highest paid Director was £2.1m (2015: £3.9m). Further details of Directors' emoluments are included in the Directors Remuneration report, which is unaudited.

6. Net interest income

	2016	Re-presented 2015
Interest receivable and similar income		
On financial assets not at fair value through profit or loss:		
On loans and advances to customers	**664.1**	776.6
On loans and advances to banks	**21.5**	19.9
On investment securities	**72.3**	71.9
Net interest income on net defined benefit pension asset	**1.6**	-
Total of financial assets not at fair value through profit or loss	**759.5**	868.4
On financial assets at fair value through profit or loss:		
Net interest expense on financial instruments hedging assets	**(28.2)**	(60.7)
Net interest income on financial instruments not in a hedging relationship	**6.5**	13.9
Total interest receivable and similar income	**737.8**	821.6

	2016	Re-presented 2015
Interest expense and similar charges		
On financial liabilities not at fair value through profit or loss:		
On customer accounts	**(204.8)**	(248.2)
On subordinated liabilities, debt securities in issue and other deposits	**(316.5)**	(286.3)
Net interest expense on net defined benefit pension liability	**(0.6)**	-
Total of financial liabilities not at fair value through profit or loss	**(521.9)**	(534.5)
On financial liabilities at fair value through profit or loss:		
Net interest income on financial instruments hedging liabilities	**8.5**	8.9
Net interest (expense)/income on financial instruments not in a hedging relationship	**(4.1)**	3.2
Total interest expense and similar charges	**(517.5)**	(522.4)

Interest expense on subordinated liabilities and debt securities in issue includes fair value unwind on debt securities in issue of £176.8m (2015: £143.5m), further details of which are provided in note 38.

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

7. Net fee and commission income/(expense)

	2016	2015
Fee and commission income		
On items not at fair value through profit or loss	**88.7**	131.8
On trust or fiduciary activities that result from holding or investing in assets on behalf of others	**-**	0.1
Total fee and commission income	**88.7**	131.9

	2016	2015
Fee and commission expense		
On items not at fair value through profit or loss	**(47.8)**	(59.7)
On items at fair value through profit or loss	**-**	(0.4)
Total fee and commission expense	**(47.8)**	(60.1)

8. Other operating income/(expense)

	Note	2016	Re-presented 2015
Profit on sale of investment securities		**18.4**	0.9
Gain on sale of equity shares[1]		**58.1**	-
Change in fair value of investment properties	21	**0.2**	0.1
Loss on sale of loans and advances to customers		**(7.2)**	(126.0)
Fair value movement on loans and advances to customers designated at fair value[2]		**7.4**	-
Fair value movement on loans and advances to customers held for trading[2]		**(15.5)**	-
Foreign exchange gains		**8.2**	-
Expense from derivatives and hedge accounting		**(40.1)**	(24.6)
Income from assets and liabilities held at fair value through profit or loss		**23.0**	29.9
Other		**8.1**	(10.6)
Total other operating income/(expense)		**60.6**	(130.3)

1. This gain has arisen as a result of the sale of the Bank's share in Visa Europe.
2. These fair value movements arose on a debt restructure and subsequent sale relating to a loan within the Legacy Portfolio

During 2015, the Bank securitised part of its Non-core Optimum residential mortgages portfolio through the issuance of notes and residual certificates by Warwick Finance Residential Mortgages Number One plc (Warwick Finance One) and Warwick Finance Residential Mortgages Number Two plc (Warwick Finance Two). This, together with other disposals of Legacy Portfolio loans in the prior year, has contributed to the £126.0m loss on sale of loans and advances to customers for the year ended 31 December 2015.

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

9. Operating expenses

	Note	2016	Re-presented 2015
Staff costs	10	**299.3**	287.5
Depreciation of property, plant and equipment	22	**12.0**	9.9
Amortisation of intangible fixed assets	20	**29.1**	29.5
Impairment of property, plant and equipment	22	**0.5**	-
Impairment of intangible assets	20	**40.6**	0.3
Profit on sale of property, plant and equipment		**(4.8)**	(3.0)
Operating lease rentals		**20.0**	23.0
Property provisions for liabilities and charges provided in the year	31	**1.0**	3.4
Financial Services Compensation Scheme Levies	31	**4.9**	19.0
Other administrative expenses		**380.6**	396.1
Total operating expenses		**783.2**	765.7

Operating expenses have been re-presented to align to a more concise disclosure in 2016.

Impairment of intangible assets includes £32.5m (2015: £nil) associated with the cessation of the activity to transform the mortgage outsource service and the subsequent write off of an intangible asset which is no longer expected to provide future economic benefit.

10. Staff costs

	Note	**2016**	2015
Wages and salaries		**146.0**	157.6
Social security costs		**15.2**	14.5
Pension costs:			
Defined benefit plans	33	**5.0**	5.0
Defined contribution plans	33	**12.1**	17.8
Other staff costs (including contractors)		**121.0**	92.6
Total staff costs		**299.3**	287.5

Other staff costs primarily include costs paid to contractors and severance costs.

Average number of employees

The average number of persons working for the Bank during the year is as follows:

	No. of employees 2016	No. of employees 2015
Full Time	**3,748**	4,463
Part Time	**1,018**	1,251
	4,766	5,714

11. Income tax

	2016	2015
Current tax		
Current year	**(23.9)**	47.6
Prior year	**0.1**	(0.1)
Total current tax	**(23.8)**	47.5
Deferred tax		
Current year	**(41.4)**	(27.6)
Prior year	**5.5**	(3.2)
Impact of corporation tax rate changes	**1.3**	(4.5)
Total deferred tax	**(34.6)**	(35.3)
Total tax (credit)/charge	**(58.4)**	12.2

In addition to the above, included within other comprehensive income is current tax of £nil (2015: credit of £3.9m) and a deferred tax charge of £8.6m (2015: £12.5m).

Further information on deferred tax is presented in note 32. 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:

	2016	2015
Loss before taxation	**(477.1)**	(610.6)
Tax calculated at a rate of 20.0% (2015: 20.25%)	**(95.4)**	(123.6)
Effects of:		
Unrecognised deferred tax	**47.5**	74.7
Adjustment to group relief debtor	**(17.5)**	50.6
Expenses not deductible for tax purposes	**8.5**	22.7
Discount of group relief debtor	**(6.4)**	(5.2)
Adjustments to tax charge in respect of prior periods	**5.6**	(3.3)
Impact of surcharge tax	**(4.2)**	-
Other differences	**2.2**	0.8
Impact of corporation tax rate change	**1.3**	(4.5)
	(58.4)	12.2

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. The group relief debtor adjustment has arisen primarily as a result of a revised repayment profile provided by The Co-operative Group Limited. Expenses not deductible for tax purposes include provisions for compensation payments for which tax relief has been restricted.

12. Loss per share

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.

	2016	2015
Loss attributable to equity shareholders of the bank	**(418.7)**	(623.3)

Number of ordinary shares in issue (millions)		
At the beginning of the year	**451.5**	451.5
At the end of the year	**451.5**	451.5

Weighted average number of ordinary shares in issue (millions)	**451.5**	451.5
Basic losses (expressed in pence per share)	**(92.74)p**	(138.05)p

13. Non-current assets classified as held for sale

	Note	2016	2015
Property, plant and equipment	22	**5.3**	3.4
		5.3	3.4

14. Cash and balances at central banks

	2016	2015
Cash in hand	**50.5**	187.3
Balances with the Bank of England other than mandatory reserve deposits	**2,756.7**	2,445.6
Included in cash and cash equivalents	**2,807.2**	2,632.9
Mandatory reserve deposits with the Bank of England	**41.0**	45.6
	2,848.2	2,678.5

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.

15. Loans and advances to banks

	2016	2015
Items in course of collection from other banks	**9.6**	18.3
Placements with other banks	**449.5**	488.5
Included in cash and cash equivalents	**459.1**	506.8
Other loans and advances to banks	**377.8**	364.2
	836.9	871.0

16. a) Loans and advances to customers

	2016	2015
Gross loans and advances	**19,575.0**	19,935.6
Less: allowance for losses	**(122.3)**	(245.2)
	19,452.7	19,690.4

Loans and advances to customers include £188.9m (31 December 2015: £174.0m) of financial assets at fair value through profit or loss designated at initial recognition to eliminate or significantly reduce a measurement or recognition inconsistency, and £4.1m (31 December 2015: £4.2m) of financial assets held for trading. Of these, £118.5m (31 December 2015: £103.9m) are secured by real estate collateral.

Loans and advances to customers include £1.8bn (31 December 2015: £3.2bn) securitised under the Bank's securitisation and covered bond programmes. The Bank remains exposed to substantially all of the risks and rewards of ownership of these assets. Secured on these mortgage assets are £nil (31 December 2015: £10.1m) of deposits by banks and £1.1bn (31 December 2015: £2.3bn) of fixed and floating rate notes.

Concentration of exposure

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

Allowance for losses on loans and advances

	Core		Non-core		
	Individual	**Collective**	**Individual**	**Collective**	**Total**
2016					
At the beginning of the year	**3.8**	**102.3**	**128.3**	**10.8**	**245.2**
Reclassification between collective & individual	**(2.8)**	**2.8**	**(9.9)**	**9.9**	**-**
Disposal of UTB	**-**	**-**	**-**	**-**	**-**
(Release)/charge against profits	**(0.1)**	**0.9**	**20.6**	**(4.6)**	**16.8**
Amounts written off	**(0.4)**	**(44.2)**	**(91.6)**	**(2.3)**	**(138.5)**
Unwind of discount allowance	**-**	**-**	**(1.2)**	**-**	**(1.2)**
At the end of the year	**0.5**	**61.8**	**46.2**	**13.8**	**122.3**

The £16.8m charge against profits as shown in the table above, reconciles to the net impairment gain as per the income statement, as shown below:

	Note	**2016**
Net impairment gain shown in income statement		**(6.2)**
Amounts recovered against amounts previously written off		**19.0**
Transfer to loss on sale of assets - loans and receivables		**-**
Provision against fair value adjustment for hedged risk	16b	**4.0**
Charge against profits shown above		**16.8**

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

	Note	2015
Net impairment gain shown in income statement		(48.6)
Amounts recovered against amounts previously written off		7.5
Transfer to loss on sale of assets - loans and receivables		(40.9)
Provision against fair value adjustment for hedged risk	16b	44.3
Release against profits shown above		(37.7)

A reclassification of retail secured provisions from ‘individual’ to ‘collective’ has been made in the year, to better reflect the nature of the provisioning calculation.

Core provisions are analysed in further detail below:

	Core						
	Retail		**BaCB**		**Other**		**Total**
	Individual	**Collective**	**Individual**	**Collective**	**Individual**	**Collective**	**Core**
2016							
At the beginning of the year	**2.8**	**101.5**	**1.0**	**0.8**	**-**	**-**	**106.1**
Reclassification between collective & individual	**(2.8)**	**2.8**	**-**	**-**	**-**	**-**	**-**
Charge/(release) against profits	**-**	**1.2**	**(0.1)**	**(0.3)**	**-**	**-**	**0.8**
Amounts written off	**-**	**(44.2)**	**(0.4)**	**-**	**-**	**-**	**(44.6)**
Unwind of discount allowance	**-**	**-**	**-**	**-**	**-**	**-**	**-**
At the end of the year	**-**	**61.3**	**0.5**	**0.5**	**-**	**-**	**62.3**

Specific provisions on Retail have been reclassified to collective during the year following a change in interpretation of a specific provision.

	Core						
	Retail		BaCB		Other		Total
	Individual	Collective	Individual	Collective	Individual	Collective	Core
2015							
At the beginning of the year	1.0	107.3	1.4	2.2	2.1	0.5	114.5
Disposal of UTB	-	-	-	-	(2.1)	(0.5)	(2.6)
(Release)/charge against profits	(1.4)	5.6	0.1	(1.4)	-	-	2.9
Amounts written back off	3.2	(9.1)	(0.5)	-	-	-	(6.4)
Unwind of discount allowance	-	(2.3)	-	-	-	-	(2.3)
At the end of the year	2.8	101.5	1.0	0.8	-	-	106.1

Non-core provisions are analysed in further detail below:

	Non-core				
	Legacy Portfolio		**Optimum**		**Total**
	Individual	**Collective**	**Individual**	**Collective**	**Non-core**
2016					
At the beginning of the year	**118.4**	**7.5**	**9.9**	**3.3**	**139.1**
Reclassification between collective & individual	**-**	**-**	**(9.9)**	**9.9**	**-**
Disposal of UTB	**-**	**-**	**-**	**-**	**-**
Charge/(release) against profits	**20.6**	**(6.2)**	**-**	**1.6**	**16.0**
Amounts written off	**(91.6)**	**-**	**-**	**(2.3)**	**(93.9)**
Unwind of discount allowance	**(1.2)**	**-**	**-**	**-**	**(1.2)**
At the end of the year	**46.2**	**1.3**	**-**	**12.5**	**60.0**

	Non-core				
	Legacy Portfolio		Optimum		Total
	Individual	Collective	Individual	Collective	Non-core
2015					
At the beginning of the year	386.8	16.7	9.5	12.4	425.4
Charge/(release) against profits	12.6	(9.2)	(34.9)	(9.1)	(40.6)
Amounts written off	(279.5)	-	35.3	-	(244.2)
Unwind of discount allowance	(1.5)	-	-	-	(1.5)
Interest charges on impaired loans	-	-	-	-	-
At the end of the period	118.4	7.5	9.9	3.3	139.1

Loans and advances to customers include finance lease receivables:

	2016	2015
Gross investment in finance leases may be analysed as follows:		
No later than one year	**8.0**	7.3
Later than one year and no later than five years	**15.3**	18.9
Later than five years	**14.1**	17.3
	37.4	43.5
Unearned future finance income on finance leases	**(8.7)**	(10.7)
Net investment in finance leases	**28.7**	32.8

The net future finance leases may be analysed as follows:

	2016	2015
No later than one year	**6.4**	5.4
Later than one year and no later than five years	**11.8**	14.4
Later than five years	**10.5**	13.0
	28.7	32.8

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.

16. b) Fair value adjustments for hedged risk

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

	2016	2015
Gross fair value adjustments for hedged risk	**131.6**	98.0
Less: impairment provision	**-**	(4.0)
	131.6	94.0

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

	2016	2015
At the beginning of the year	**4.0**	48.3
Release for the year	**(4.0)**	(44.3)
At the end of the year	**-**	4.0

17. Investment securities

a) Loans and receivables

	2016	2015
Loans and receivables:		
Listed	**13.8**	15.0
Unlisted	**-**	-
Total gross investment securities - loans and receivables	**13.8**	15.0
Less: allowance for losses	**-**	-
Total net investment securities - loans and receivables	**13.8**	15.0

Movement in investment securities - loans and receivables

	2016	2015
At the beginning of the year	**15.0**	18.1
Disposals and maturities	**(1.2)**	(3.2)
Amortisation	**-**	0.1
At the end of the year	**13.8**	15.0

b) Available for sale

	2016	2015
Available for sale:		
Listed	**3,538.1**	4,296.8
Unlisted	**-**	-
Total gross investment securities available for sale	**3,538.1**	4,296.8
Less: allowance for losses	**-**	-
Total net investment securities available for sale	**3,538.1**	4,296.8

Included in investment securities are repurchase receivables of £833.6m. These receivables are gilts subject to repurchase transactions where the transferee has the ability to re-pledge or sell the assets. The Bank has pledged £165.1m of Warwick Finance Two securitisation notes, with a 17% haircut, as security against the increased shortfall in the actuarial funding shortfall estimated by the scheme actuary on 31 March 2016. See note 33 for further details.

Movement in investment securities - available for sale

	2016	2015
At the beginning of the year	**4,296.8**	3,167.5
Acquisitions	**363.7**	1,916.3
Disposals and maturities	**(1,161.5)**	(404.9)
Disposal of UTB[1]	**-**	(338.7)
Fair value movements through equity	**12.7**	(19.1)
Fair value through profit or loss	**32.2**	(17.7)
Amortisation	**(1.5)**	(6.7)
Movement in interest accrual	**(4.3)**	0.1
At the end of the year	**3,538.1**	4,296.8

1. Majority of Bank's shareholding in UTB was disposed of in the prior year.

c) Fair value through profit or loss

	2016	2015
Fair value through profit or loss:		
Listed	**-**	582.4
Unlisted	**-**	-
Total gross investment securities (FVTPL)	**-**	582.4
Less: allowance for losses	**-**	-
Total net investment securities (FVTP)	**-**	582.4

Movement in investment securities (FVTPL)

	2016	2015
At the beginning of the year	**582.4**	1,236.9
Disposals and maturities	**(566.5)**	(639.9)
Fair value through profit or loss	**(13.1)**	(10.7)
Movement in interest accrual	**(2.8)**	(3.9)
At the end of the year	**-**	582.4

d) Analysis of investment securities by issuer

	2016	2015
Investment securities issued by public bodies:		
Government securities	**1,661.5**	2,518.1
Other public sector securities	**173.7**	87.2
Total investment securities issued by public bodies	**1,835.2**	2,605.3
Other debt securities:		
Other floating rate notes	**395.5**	674.2
Mortgage backed securities	**1,321.2**	1,614.7
Total investment securities issued by other issuers	**1,716.7**	2,288.9
Total investment securities	**3,551.9**	4,894.2

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

18. Derivative financial instruments

The Bank has entered, as principal, into various derivatives either as economic hedges which are treated as held for trading (not in a qualifying hedge relationship), or in a qualifying hedge accounting relationship for the management of interest rate 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.

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.

	2016 Fair value		2015 Fair Value	
	Assets	**Liabilities**	Assets	Liabilities
Derivatives held for non-trading purposes				
Derivatives designated as cash flow hedges:				
Interest rate swaps	**72.1**	**(3.6)**	35.1	(9.2)
Derivatives designated as fair value hedges:				
Interest rate swaps	**64.4**	**(246.3)**	29.3	(189.6)
Cross currency interest rate swaps	**123.3**	**-**	157.8	-
Derivatives held for non-trading purposes for which hedge accounting has not been applied:				
Interest rate swaps	**162.4**	**(193.2)**	124.8	(143.6)
Cross currency interest rate swaps	**-**	**(0.5)**	2.2	(0.3)
Forward currency transactions	**0.4**	**(0.6)**	2.1	(4.0)
OTC interest rate options	**0.3**	**(0.3)**	0.2	(0.2)
Equity swaps	**2.6**	**-**	18.6	-
Total derivative assets/(liabilities) held for non-trading purposes	**425.5**	**(444.5)**	370.1	(346.9)
Total recognised derivative assets/(liabilities)	**425.5**	**(444.5)**	370.1	(346.9)

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 2016 was £1.1m (2015: £3.2m). CVAs and DVAs are not applied to derivatives that are fully cash collateralised.

19. Equity shares

	2016	2015
Investment securities:		
Listed	**0.2**	0.1
Unlisted	**46.6**	55.5
	46.8	55.6
Included above are the following trade investments:		
Unity Trust Bank	**2.0**	1.9
Visa International - (38,847 Series B Preference Shares) (2015: 0)	**19.3**	-
Visa Europe - 1 ordinary share of €10	**-**	51.2
VocaLink Holdings Limited - 4,416,165 ordinary shares of £1 each (2015: 4,416,165)	**25.3**	2.4

Equity shares are classified as available for sale. The fair value of Visa International preference shares has been remeasured based on the equity price of Visa International shares, discounted for the estimated amount of preference shares to be clawed back and an illiquidity discount. The valuation technique used to calculate the fair value of equity shares are set out in note 38. The fair value of Vocalink Holdings Limited has been remeasured with reference to the offer that the Bank and other Vocalink shareholders have received from MasterCard to acquire a majority shareholding.

20. Intangible assets

		2016			2015		
	Note	Internally generated intangible assets	Other intangible assets	Total	Internally generated intangible assets	Other intangible assets	Total
Cost							
At the beginning of the year		**243.4**	**46.0**	**289.4**	472.1	46.0	518.1
Additions		**26.5**	**-**	**26.5**	73.0	-	73.0
Disposals		**(66.5)**	**(4.2)**	**(70.7)**	(0.3)	-	(0.3)
Disposal of UTB		**-**	**-**	**-**	(1.3)	-	(1.3)
Impairment	9	**(40.6)**	**-**	**(40.6)**	(0.3)	-	(0.3)
Write off of fully amortised assets		**-**	**-**	**-**	(296.1)	-	(296.1)
Transfer to property, plant and equipment		**-**	**-**	**-**	(3.7)	-	(3.7)
At the end of the year		**162.8**	**41.8**	**204.6**	243.4	46.0	289.4
Accumulated amortisation and impairment							
At the beginning of the year		**115.6**	**31.0**	**146.6**	387.9	26.5	414.4
Charge for the year	9	**24.9**	**4.2**	**29.1**	25.0	4.5	29.5
Disposals		**(67.0)**	**(4.2)**	**(71.2)**	(0.2)	-	(0.2)
Disposal of UTB		**-**	**-**	**-**	(1.0)	-	(1.0)
Write off of fully amortised assets		**-**	**-**	**-**	(296.1)	-	(296.1)
At the end of the year		**73.5**	**31.0**	**104.5**	115.6	31.0	146.6
Net book value							
At the end of the year		**89.3**	**10.8**	**100.1**	127.8	15.0	142.8
At the beginning of the year		**127.8**	**15.0**	**142.8**	84.2	19.5	103.7

Internally generated intangible assets of £32.5m associated with the transformation of the outsourced mortgage processing services have been impaired as detailed in note 9. Internally generated assets include £17.1m (2015: £67.5m) of assets in the course of construction.

Other intangible assets consist of a core deposit intangible of £10.8m (2015: £15.0m).

21. Investment properties

	Note	**2016**	2015
Fair value			
At the beginning of the year		**2.1**	2.1
Disposals		**(0.1)**	(0.1)
Changes in fair value	8	**0.2**	0.1
At the end of the year		**2.2**	2.1

At the year end, investment properties relate 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 level 3 of the fair value hierarchy (see note 38). 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.

All investment properties are held to generate rental income until such time that the Bank considers it appropriate to realise its investment.

22. Property, plant and equipment

2016	Note	**Land and buildings**	**Leasehold improvements**	**Computers and other equipment**	**Assets in the course of construction**	**Total**
Cost						
At the beginning of the year		**30.8**	**23.7**	**100.6**	**2.3**	**157.4**
Additions		**2.6**	**-**	**3.1**	**7.5**	**13.2**
Disposals		**(5.2)**	**(23.7)**	**(68.1)**	**-**	**(97.0)**
Disposal of UTB		**-**	**-**	**-**	**-**	**-**
Transfer from intangibles		**-**	**-**	**-**	**-**	**-**
Classified as held for sale	13	**(6.2)**	**-**	**-**	**-**	**(6.2)**
Impairment	9	**-**	**-**	**-**	**(0.5)**	**(0.5)**
At the end of the year		**22.0**	**-**	**35.6**	**9.3**	**66.9**
Accumulated depreciation						
At the beginning of the year		**8.4**	**23.6**	**79.3**	**-**	**111.3**
Charge for the year	9	**4.3**	**-**	**7.7**	**-**	**12.0**
Disposal of UTB		**-**	**-**	**-**	**-**	**-**
Disposals		**(2.7)**	**(23.6)**	**(63.5)**	**-**	**(89.8)**
Classified as held for sale	13	**(2.0)**	**-**	**-**	**-**	**(2.0)**
At the end of the year		**8.0**	**-**	**23.5**	**-**	**31.5**
Net Book Value						
At the end of the year		**14.0**	**-**	**12.1**	**9.3**	**35.4**
At the beginning of the year		**22.4**	**0.1**	**21.3**	**2.3**	**46.1**

2015	Note	Land and buildings	Leasehold improvements	Computers and other equipment	Assets in the course of construction	Total
Cost						
At the beginning of the year		46.2	25.0	142.0	1.0	214.2
Additions		0.1	-	3.9	2.5	6.5
Disposals		(11.3)	(1.3)	(47.9)	-	(60.5)
Disposal of UTB		-	-	(2.3)	-	(2.3)
Transfer from intangibles		-	-	4.9	(1.2)	3.7
Classified as held for sale	13	(4.2)	-	-	-	(4.2)
At the end of the year		30.8	23.7	100.6	2.3	157.4
Accumulated depreciation						
At the beginning of the year		15.1	24.3	107.3	-	146.7
Charge for the year	9	1.1	0.6	8.2	-	9.9
Disposals		(7.0)	(1.3)	(34.1)	-	(42.4)
Disposal of UTB		-	-	(2.1)	-	(2.1)
Classified as held for sale	13	(0.8)	-	-	-	(0.8)
At the end of the year		8.4	23.6	79.3	-	111.3
Net Book Value						
At the end of the year		22.4	0.1	21.3	2.3	46.1
At the beginning of the year		31.1	0.7	34.7	1.0	67.5

	2016	2015
The net book value of land and buildings comprises:		
Freehold	**12.7**	21.1
Leasehold	**1.3**	1.3
	14.0	22.4

23. Other assets

	2016	Re-presented 2015
Amounts recoverable within one year:		
Other assets	**0.5**	21.5
Amounts owed by The Co-operative Group	**13.0**	37.5
Deferred consideration receivable	**5.3**	5.0
Amounts recoverable after more than one year:		
Amounts owed by The Co-operative Group	**73.9**	60.1
Deferred consideration receivable	**4.0**	-
	96.7	124.1

The 2015 re-presentation is in relation to Trade debtors classification into Other assets, to better reflect the nature of the balances.

Amounts owed by The Co-operative Group include group tax relief receivable of £84.1m (2015: £60.1m). Further details of the related party relationship of the Bank with The Co-operative Group and its undertakings are contained in note 36.

24. Prepayments and accrued income

	2016	2015
Amounts recoverable within one year	**24.1**	35.4
Amounts recoverable after more than one year	**4.6**	8.1
	28.7	43.5

Prepayments totaling £16.0m have been impaired by the Bank during the year. This impairment is associated with the cessation of the activity to transform the mortgage outsource service and the subsequent write off of an asset which is no longer expected to provide future economic benefit.

25. Deposits by banks

	2016	2015
Items in course of collection	**20.5**	31.8
Deposits from other banks	**1,178.1**	694.1
	1,198.6	725.9

Included within deposits from other banks are liabilities of £1,169.3m (2015: £671.2m) secured on investment securities with a carrying value of £1,260.1m (2015: £721.7) which have been sold under sale and repurchase agreements (note 38).

26. Customer accounts - capital bonds

	2016	2015
Retail	**11.8**	77.4

The capital bonds are fixed term customer accounts with returns based on the movement in an index (e.g. 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 £11.8m (2015: £77.4m).

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 £15.7m (2015: £20.9m). However, taking into account changes in fair value of the associated swaps, the net impact to the income statement for the year is £0.4m (2015: £nil).

27. Debt securities in issue

	2016	2015
Fixed and floating rate notes	**1,625.4**	2,554.3

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. Where appropriate, the Bank applies fair value hedge accounting to reduce the accounting volatility from these positions.

Debt securities in issue include fixed and floating rate notes, the majority of which are secured on portfolios of variable and fixed rate mortgages. Some of these notes (securitisations) are redeemable in part being limited to the net capital received from mortgagors in respect of the underlying assets and payments made when the securitisations unwind. There is no obligation for the Bank to make good any shortfall out of general funds. Other notes (covered bonds secured and certificates of deposit) require the Bank to repay contractual amounts due on specified maturity dates.

28. Other borrowed funds

	2016	2015
Fixed rate subordinated notes 2025	**250.0**	250.0
Fixed rate subordinated notes 2023	**206.0**	206.0
Issue costs, discounts and accrued interest	**2.4**	1.0
Fair value hedge accounting adjustment	**14.2**	2.9
	472.6	459.9

The 2025 subordinated notes were issued on 1 July 2015 and have a call date on 1 July 2020. These notes carry an annual interest rate of 8.5% to maturity and interest is payable annually in arrears. The 2023 subordinated notes were issued on 20 December 2013 and mature on 20 December 2023. These notes carry an annual interest rate of 11% to maturity and interest is payable quarterly in arrears.

The notes have been admitted to trading on the London Stock Exchange; they are Tier 2 capital and an unsecured obligation of the Bank.

29. Other liabilities

	2016	2015
Amounts falling due within one year:		
ATM creditor	**4.6**	1.2
Other creditors	**32.4**	59.6
Amounts falling due after one year:		
Other creditors	**8.9**	8.0
	45.9	68.8

Other creditors of the Bank include finance lease obligations as follows:

	Present value of lease payments		**Future minimum lease payments**	
	2016	2015	**2016**	2015
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**	1.2	**1.5**	1.6
	1.4	1.3	**1.6**	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.

30. Accruals and deferred income

	2016	2015
Amounts falling due within one year	**81.8**	129.2
Amounts falling due after one year	**33.5**	23.3
	115.3	152.5

31. Provisions for liabilities and charges

2016	Note	**Property**	**FSCS levies**	**PPI**	**Conduct/ legal**	**Separation**	**Other**	**Total**
At the beginning of the year		**43.7**	**10.8**	**87.0**	**268.7**	**64.3**	**24.7**	**499.2**
Provided/(released) in the year:								
Interest income		**-**	**-**	**-**	**2.3**	**-**	**-**	**2.3**
Operating expense	9	**1.0**	**4.9**	**-**	**0.2**	**16.2**	**39.1**	**61.4**
Provision for customer redress		**-**	**-**	**36.0**	**(13.6)**	**-**	**-**	**22.4**
Utilised during the year		**(12.0)**	**(9.1)**	**(32.6)**	**(178.7)**	**(53.2)**	**(23.3)**	**(308.9)**
At the end of the year		**32.7**	**6.6**	**90.4**	**78.9**	**27.3**	**40.5**	**276.4**
Provisions were analysed as follows:								
Amounts falling due within one year		**16.1**	**6.6**	**34.1**	**71.3**	**27.3**	**31.3**	**186.7**
Amounts falling due after one year		**16.6**	**-**	**56.3**	**7.6**	**-**	**9.2**	**89.7**
Total provisions		**32.7**	**6.6**	**90.4**	**78.9**	**27.3**	**40.5**	**276.4**

2015	Note	Property	FSCS levies	PPI	Conduct/ legal	Separation	Other	Total
At the beginning of the year		24.4	12.7	73.6	362.5	112.3	32.0	617.5
Transferred from CFSMS		23.8	-	-	-	-	6.6	30.4
Provided/(released) in the year:								
Interest income		-	-	-	58.3	-	-	58.3
Operating expense	9	3.4	19.0	-	-	8.9	14.2	45.5
Provision for customer redress		-	-	71.8	63.6	-	(0.5)	134.9
Utilised during the year		(7.9)	(20.7)	(58.4)	(215.7)	(56.9)	(27.5)	(387.1)
Disposal of UTB		-	(0.2)	-	-	-	(0.1)	(0.3)
At the end of the year		43.7	10.8	87.0	268.7	64.3	24.7	499.2
Provisions were analysed as follows:								
Amounts falling due within one year		26.9	10.8	40.7	246.1	64.3	23.0	411.8
Amounts falling due after one year		16.8	-	46.3	22.6	-	1.7	87.4
Total provisions		43.7	10.8	87.0	268.7	64.3	24.7	499.2

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 £0.6m (2015: £0.3m) 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 could be liable to pay a proportion of the outstanding borrowings that the FSCS has borrowed from HM Treasury. The ultimate FSCS levy to the industry as a result of the historic claims 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.

By virtue of its holding deposits protected under the FSCS scheme the Bank has an obligation to pay levies in respect of the interest cost for 2016/17 scheme year. The interest rate chargeable on the loan and levied to the industry is subject to a floor equal to the higher of HM Treasury's own cost of borrowing and GBP LIBOR with 12-month maturity.

The Bank has provided £6.6m as at 31 December 2016 (31 December 2015: £10.8m) for its share of the levies raised by the FSCS. The Bank's interest levy provision calculation includes estimates of the total FSCS levy in each levy year and estimates of the Bank's market participation in each levy year.

Payment Protection Insurance (PPI)

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

The FSA issued a policy statement in August 2010, which amended the 'Disputes Resolution: Complaints' section of the FSA Handbook, setting out new rules for handling complaints, including complaints of PPI mis-selling. The Bank must comply with the policy statement which requires complainants to receive adequate redress and the Bank to deliver fair outcomes and treat customers fairly including non-complainants. An additional provision of £36.0m was recognised in the year (2015: £71.8m), in respect of the total expected cost to the Bank of carrying out this work and paying compensation. The provision increase reflects the Bank's year end estimates of the impact of both the FCA Consultation Paper CP16/20 and the FCA's publication of PS17/3 on 2 March 2017 which specifies that the time bar will end on 29 August 2019.
As a result, the total provision raised by the Bank to date is £459.8m.

Conduct/legal provisions

During the period the Bank provided £2.3m (2015: £58.3m) in respect of interest income in relation to breaches of the technical requirements of the CCA.

The Bank made a net release of £13.6m (31 December 2015: £63.6m net charge) of provision for customer redress. This includes a £12.5m release on breaches of the technical requirements of the CCA, following amendments to the underlying redress assumptions as the remediation programme nears completion. There was a further release of £15.3m on other projects including Interest Rate Hedging and Affinion, £20.1m charge on the Mortgage Rectification Programme relating to historic calculations of the Monthly Mortgage Payments, and a net release of £5.9m on other Mortgage issues following the maturity of projects and agreed redress approach with the FCA.

Other

On 10 February 2017, the Bank and its mortgage outsource provider reached agreement on the settlement of outstanding disputes between them and on changes to the contract for the provision of ongoing services. Accordingly a provision of £21.7m is included in the financial statements as at 31 December 2016.

32. Deferred tax

The movements on deferred tax are as follows:

	2016			2015		
	Deferred tax asset	**Deferred tax liability**	**Total**	Deferred tax asset	Deferred tax liability	Total
Deferred tax at the beginning of the year	**7.6**	**(47.8)**	**(40.2)**	21.0	(84.0)	(63.0)
Credited/(charged) to the income statement:						
Current year	**8.6**	**32.8**	**41.4**	(8.2)	35.8	27.6
Prior year	**(5.5)**	**-**	**(5.5)**	3.2	-	3.2
Impact of corporation tax rate charge	**(2.1)**	**0.8**	**(1.3)**	4.1	0.4	4.5
	1.0	**33.6**	**34.6**	(0.9)	36.2	35.3
Credited/(charged) to other comprehensive income:						
Available for sale	**2.5**	**-**	**2.5**	(12.5)	-	(12.5)
Cash flow hedges	**(7.3)**	**-**	**(7.3)**	-	-	-
Pension reserve	**(3.8)**	**-**	**(3.8)**	-	-	-
	(8.6)	**-**	**(8.6)**	(12.5)	-	(12.5)
Deferred tax at the end of the year	**-**	**(14.2)**	**(14.2)**	7.6	(47.8)	(40.2)

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

	2016		2015	
	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	**37.1**	**-**	20.4	-
Fair value adjustment - The Co-operative Bank subsidiaries	**-**	**(11.7)**	-	(44.9)
Cash flow hedges	**(17.4)**	**-**	(11.2)	-
Unrealised appreciation on investments	**(11.8)**	**-**	(13.1)	-
Pensions and post-retirement benefits	**(5.1)**	**-**	-	-
Other temporary differences	**(2.8)**	**(2.5)**	7.5	(2.9)
Capital losses	**-**	**-**	4.0	-
	-	**(14.2)**	7.6	(47.8)

The deferred tax liability of £11.7m (2015: £44.9m) relating to fair value adjustments is net of a deferred tax asset of £5.3m (2015: £4.1m).

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

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

	2016	2015
Capital allowances on fixed assets and assets leased to customers	**(16.7)**	(8.3)
Fair value adjustment - The Co-operative Bank subsidiaries	**(33.2)**	(31.5)
Cash flow hedges	**(1.1)**	(0.3)
Unrealised appreciation on investments	**3.8**	-
Pensions and post-retirement benefits	**1.3**	-
Other temporary differences	**7.3**	8.8
Capital losses	**4.0**	(4.0)
	(34.6)	(35.3)

Deferred tax assets totalling £409.0m (2015: £356.2m) 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 £1,952.0m (with deferred tax of £351.6m) and other temporary differences of £229.4m (with deferred tax of £57.4m). Deferred tax assets of £47.5m (2015: £74.7m) in respect of the current year have not been recognised.

The UK corporation tax will reduce from 20% to 19% (effective from 1 April 2017) and then to 17% (effective from 1 April 2020); the latter rate change was enacted on 15 September 2016. A banking surcharge tax of 8% also applies to the Bank (effective from 1 January 2016). Deferred tax has been calculated by reference to the most appropriate rate based on forecasts.

New legislation was enacted in 2016 with the effect that from 1 April 2016, only 25% of a bank's taxable profits can be relieved by brought forward losses. The Government announced on 16 March 2016 that further changes to the rules on the utilisation of tax losses will be introduced effective from 1 April 2017, however the new legislation has not yet been enacted.

33. Pensions

Pensions charge

The pension charge in the income statement at 31 December 2016 was £16.0m (2015: £22.8m) which includes £5.0m (2015: £5.0m) as the Bank's contribution to the Pace deficit recovery charge.

The pension charge relates to staff costs charges of £17.1m (see note 10), £1.6m interest income, and £0.5m of other expenses.

a) The Co-operative Pension Scheme (Pace)

The Bank participates in Pace, a hybrid scheme, consisting of a closed defined benefit section (Pace Complete) and a defined contribution section (Pace DC). The Pace scheme is considered to be a multi-employer scheme under IAS 19 Employee benefits (revised 2011) with The Co-operative Group being the Principal Employer.

In October 2015, Pace Complete closed to new members. Benefits built up in the scheme have been preserved and remain in the scheme with annual increases being applied in line with the scheme rules. From 1 October 2015, members in Pace Complete automatically began building up benefits in Pace DC (unless they opted out).

i. Scheme background

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).

Following separation of the Bank from the wider Co-operative Group as a result of the LME, the Bank remained a participating employer in the Pace scheme. During 2016, the Bank continued discussions with The Co-operative Group and the Pace Trust, with the aim of separating its liabilities in the scheme from those of other participating employers or apportioning its liabilities to other participating employers or exiting the scheme and apportioning its liabilities to other participated employers. The outcome of the negotiations remains highly uncertain, and any solution would require agreement by the Pace Trustee. Only a sectionalisation of the scheme would provide clarity of the Bank's share of liabilities in relation to employee benefits accrued at the balance sheet date.

ii. Risks arising from the scheme

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 until such a time that either the Bank's share of the liabilities or an agreement over Bank's exit from the scheme is agreed.

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 spent most of their time working on behalf of the Bank were transferred from CFSMS to the Bank. This increased the number of Bank employees participating in the Pace scheme in 2014.

There are also '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.

There continues to be insufficient information available to consistently and reliably identify the Bank's share of Pace liabilities and employer costs. For this reason 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.

Currently, 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.

iii. 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.

iv. Contribution payments

On an accounting basis the Pace scheme reported a surplus of £1,266.3m as at 31 December 2015, which at the date of this report, is the most recent accounting valuation available. 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.

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 5 April 2015 was £304.0m. 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. The triennial valuation as at 5 April 2016 has not yet been finalised.

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. As separation negotiations continue the Bank has paid a further £5.0m during 2016 (2015: £5.0m). 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 Bank also pays contributions in respect of the employed members of the defined contribution section of the scheme. Members can choose to pay up to a maximum core contribution of 8% of salary and the Bank 'double-matches' these up to a maximum member contribution of 5%. So, for members paying 5% or more, the Bank will contribute 10% of salary into the scheme. 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, which support the 31December 2015 accounting valuation, are as follows:

	2015
The principal assumptions used to determine the liabilities of the Pace scheme are:	
Discount rate	3.80%
Rate of increase in salaries	3.55%
Future pension increases where capped at 5.0% per annum	3.20%
Future pension increases where capped at 2.5% per annum	2.20%
Assumptions used to determine net pension cost for the Pace scheme are:	
Discount rate	3.70%
Rate of increase in salaries	3.30%

The average life expectancy (in years) for mortality tables used to determine scheme liabilities for the Pace scheme at the 2016 year end is:

	Male	**Female**
Life expectancy:		
Member currently aged 65 (current life expectancy)	**22.9**	**25.2**
Member currently aged 45 (life expectancy at age 65)	**25.2**	**27.4**

The balance sheet amounts attributable to the entire scheme are as follows:

	2015
Fair value of plan assets	9,185.0
Present value of funded obligations	(7,918.4)
	1,266.6
Present value of unfunded obligations	(0.3)
	1,266.3

The asset allocations at the end of the year were as follows:

	2015
Equities	1,906.8
Liability driven investments	5,524.5
Alternative growth	850.0
Property	305.0
Other	598.7

The table below shows the value of the assets in each category which have a quoted market price:

	2015
Equities	1,906.8
Liability driven investments	5,524.5
Other	150.8

b) Britannia Pension Scheme (Britannia Scheme)
The Britannia Scheme is a defined benefit scheme.

i. Scheme Background and risks arising from the scheme
In 2009, following the transfer of engagements of Britannia Building Society, CFSMS, a Co-operative Group subsidiary, became principal employer of the scheme, and the three other participating employers of the Britannia Scheme were Bank wholly owned subsidiary entities.

The scheme closed on 6 October 2010 with active members at the date of closure being invited to join the relevant defined benefit or contribution Co-operative Pension Scheme 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 at the time (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 remained the sponsoring employer of the scheme, the Bank recognised the total assets and liabilities of the scheme on the balance sheet as at 31 December 2014.

On 23 December 2015, a Flexible Apportionment Arrangement (FAA) was executed, at which time the Co-operative Bank plc was named as a participating employer and replaced CFSMS as the principal employer, following which, CFSMS, WMS and PHL departed from the scheme with their share of the scheme's liabilities being transferred to the Bank. As the Bank had already been recognising the total assets and liabilities of the scheme on its balance sheet, due to a guarantee it provided, the FAA has not had a significant impact on the Bank's exposure to the risks of the scheme.

A change to the scheme rules was effective from 30 June 2016 which allows the Bank to receive a refund of surplus at the end of the scheme's life when there are no members remaining. On this basis the asset restriction under IFRIC 14 was removed. The Bank has recognised a net pension asset of £20.3m (2015: £nil due to the asset restriction being in place) on its balance sheet in relation to the scheme. In addition the Bank has recognised a £3.7m liability (2015: £3.1m liability) representing unfunded pension liabilities of the Britannia Supplementary Pension and Life Assurance Plan. Benefits under this unfunded arrangement are valued on the same assumptions as the Britannia Scheme and are disclosed as unfunded obligations.

ii. 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.

iii. 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 April 2014, in accordance with the scheme specific funding requirements of the Pensions Act 2004. The actuarial valuation of the Britannia Scheme as at 5 April 2014, completed in accordance with the scheme specific funding requirements of the Pensions Act 2004, showed the Britannia Scheme had a shortfall of £41.2m. In respect of the deficit, the trustees of the scheme and the Bank have agreed that contributions will be paid totalling £50m, with £5m paid during 2016. The Scheme Actuary estimated the scheme shortfall had increased to £137m as at 31 March 2016. With agreement of the Trustee, the Bank therefore provided security against the increased shortfall in the form of £165.1m AAA rated retained Warwick Finance Two securitisation notes, with a 17% haircut. This security becomes enforceable in the event that Bank does not meet its deficit recovery payments agreed with the Trustee, bank insolvency or the Bank fails to adhere to terms of the security deed. Due to the removal of the asset restriction, no further liability has been recognised in regard to the funding arrangement. The next valuation date for the scheme will be 5 April 2017.

iv. 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 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.

v. 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 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.

vi. 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.

vii. Indirect participation

In 2016 the Bank paid approximately £0.3m (2015: £1.0m) 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.

The key aspects of the defined benefit section of the Britannia scheme are as follows:

	2016	2015
The principal assumptions used to determine the defined benefit liabilities of the Britannia Pension Scheme are:		
Discount rate	**2.70%**	3.90%
Revaluation in deferment (CPI)	**2.30%**	2.20%
Future pension increases where capped at 5.0% per annum	**3.20%**	3.15%
Future pension increases where capped at 5.0% per annum, minimum 3.0%	**3.65%**	3.60%
The principal assumptions used to determine the net pension cost of the Britannia defined benefit scheme are:		
Discount rate	**3.90%**	3.70%
Price Rate Inflation (RPI)	**3.30%**	3.20%
Rate of increase in salaries	**n/a**	n/a

The average life expectancy (in years) for mortality tables used to determine defined benefit scheme liabilities for the former Britannia Building Society scheme at the 2016 year end is:

	Male	**Female**
Life expectancy:		
Member retiring today (member age 60)	**27.7**	**29.8**
Member retiring in 20 years (member age 40 today)	**30.1**	**32.3**

	2016	2015
Fair value of plan assets	**854.9**	720.3
Present value of funded obligations	**(834.6)**	(639.9)
	20.3	80.4
Pension surplus not recognised under IAS 19 (revised 2011)	**-**	(80.4)
Present value of unfunded obligations	**(3.7)**	(3.1)
	16.6	(3.1)

The amounts recognised in the income statement of the Bank are as follows:

	2016	2015
Interest expense on defined benefit obligation	**(24.2)**	(24.9)
Interest income on plan assets	**27.4**	26.6
Interest expense on effect of onerous liability	**(1.6)**	(1.7)
Total net interest income	**1.6**	-
Administrative expenses	**(2.1)**	(1.5)
Defined benefit costs included in income statement	**(0.5)**	(1.5)

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

	2016	2015
Defined benefit obligation at the start of the year	**639.9**	683.7
Past service cost	**-**	(6.0)
Interest expense	**24.2**	24.9
Benefit payments from plan assets	**(42.0)**	(21.8)
Remeasurements:		
Effect of changes in demographic assumptions	**-**	(6.7)
Effect of changes in financial assumptions	**212.5**	(30.9)
Effect of experience assumptions	**-**	(3.3)
Defined benefit obligation at the end of the year	**834.6**	639.9

	2016	**2015**
Fair value of plan assets at the start of the year	**720.3**	728.5
Interest income	**27.4**	26.6
Employer contributions	**5.9**	0.9
Benefit payments from plan assets	**(42.0)**	(21.8)
Administrative expenses paid from plan assets	**(2.1)**	(1.5)
Return on plan assets (excluding interest income)	**145.4**	(12.4)
Fair value of plan assets at the end of the year	**854.9**	720.3

Changes in the effect of the asset ceiling are as follows:

	2016			Restated 2015		
	Asset	**Defined benefit obligation**	**Asset ceiling**	Asset	Defined benefit obligation	Asset ceiling
At the start of the year	**720.3**	**(639.9)**	**(80.4)**	728.5	(683.7)	(44.8)
Past service cost	**-**	**-**	**-**	-	6.0	-
Interest income/(expense)	**27.4**	**(24.2)**	**(1.6)**	26.6	(24.9)	(1.7)
Employer contributions	**5.9**	**-**	**-**	0.9	-	-
Administrative expenses paid from plan assets	**(2.1)**	**-**	**-**	(1.5)	-	-
Benefits paid	**(42.0)**	**42.0**	**-**	(21.8)	21.8	-
Actuarial gain/(losses)	**145.4**	**(212.5)**	**-**	(12.4)	40.9	-
Changes in asset ceiling in the year	**-**	**-**	**82.0**	-	-	(33.9)
Fair value of plan assets at the end of the year	**854.9**	**(834.6)**	**-**	720.3	(639.9)	(80.4)

Actuarial losses for 2015 have been restated in the table above.

The asset allocations at the year-end were as follows:

	2016	2015
Equities	**159.0**	126.0
Liability driven investments	**548.3**	452.1
Alternative growth	**4.8**	35.0
Property	**67.2**	81.7
Other	**75.6**	25.5

The table below shows the value of the assets in each category which have a quoted market price:

	2016	2015
Equities	**35.6**	126.0
Liability driven investments	**159.0**	415.9
Other	**539.3**	22.7

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 in the discount rate of 0.1% would result in a £20.1m decrease in the present value of the defined benefit obligation.
Inflation	Inflation is a significant assumption as it is used to determine salary-related benefits and pension increases before and after retirement. The assumption adopted is consistent with the discount rate adopted. A decrease in the inflation rate of 0.1% would result in a £11.0m decrease in the present value of the defined benefit obligation.
Mortality rates	The mortality assumptions adopted are based on those recommended by the actuaries that advise the scheme management and reflect the most recent information as appropriate. 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 £17.7m.

Bank (unfunded) pension scheme
The Bank also operates a small unfunded pension scheme.

	2016	2015	2014	2013	2012
Price inflation rate (RPI)	**3.3%**	3.2%	3.3%	3.6%	3.3%
Rate of increase in salaries	**n/a**	n/a	3.3%	5.1%	4.8%
Discount rate	**2.7%**	3.9%	3.7%	4.7%	4.6%

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.

The values of the assets and liabilities of the unfunded pension scheme were:

	2016	2015
Deficit in scheme	**(5.2)**	(4.4)
Analysis of amount charged to income statement:		
Interest expense on pension scheme liabilities	**0.2**	0.2

Changes in the present value of the scheme liabilities are as follows:

	2016	2015
Opening defined benefit liabilities	**4.4**	4.7
Current service cost	**-**	-
Interest expense on liabilities	**0.2**	0.2
Actuarial (gains)/losses	**0.8**	(0.3)
Benefits paid	**(0.2)**	(0.2)
Closing defined benefit liabilities	**5.2**	4.4

Amounts recognised in the statement of comprehensive income

	2016	2015
Actuarial (gains)/losses on scheme liabilities during the year	**0.8**	(0.3)
Total scheme gains/(losses) during the year	**0.8**	(0.3)

The amounts for the current year are as follows:

	2016	2015
Defined benefit obligation	**(5.2)**	(4.4)
Deficit in scheme	**(5.2)**	(4.4)

34. Contingent liabilities
The tables below provide the contractual amounts and risk weighted amounts of contingent liabilities and commitments. The contractual amounts indicate the volume of business outstanding at the balance sheet date and do not represent amounts at risk. The risk weighted amounts have been calculated in accordance with the CRD IV rules.

The contingent liabilities, as detailed below, arise in the normal course of banking business and it is not practical to quantify their future financial effect.

	Audited	**Unaudited**	Audited	Unaudited
	Contractual amount 2016	**Risk weighted amount 2016**	Contractual amount 2015	Risk weighted amount 2015
Contingent liabilities:				
Guarantees and irrecoverable letters of credit	**12.1**	**4.6**	21.0	15.0
Other commitments:				
Undrawn formal standby facilities, credit lines and other commitments to lend (includes revocable and irrevocable commitments)[1]	**2,277.4**	**296.2**	2,571.7	313.5
	2,289.5	**300.8**	2,592.7	328.5

1. Undrawn loan commitments include revocable commitments which are unused credit card limits of £1,376.2m (2015: £1,557.6m).

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 38 for further details of assets pledged.

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 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 2016	Land and buildings 2015
Falling due:		
Within one year	**12.2**	14.0
Between one and five years	**33.7**	30.2
In five years of more	**73.6**	84.3
	119.5	128.5

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 £4.2m (2015: £13.9m).

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 possibility 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 may also be other regulatory investigations and action against the Bank in the future 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 outcome of any ongoing disputes and legal, regulatory or other investigations or proceedings is currently uncertain.

Sale of the Bank's share in Visa Europe Limited (VE)
The sale of the Bank's share in VE completed on 21 June 2016. In connection with the transaction, the Bank and certain other members of VE have entered into a Loss Sharing Agreement (LSA) pursuant to which the Bank has agreed, on a several and not joint basis, to indemnify Visa Inc. (VI) for certain losses which may be incurred as a result of existing and potential litigation relating to the setting and implementation of domestic Merchant Interchange Fee (MIF) rates in the UK. This indemnification is up to a maximum amount of the upfront cash consideration to be received by the Bank, being approximately €50m. For any such losses, the new arrangement under the LSA will replace the potential uncapped indemnity under the existing VE Operating regulations, which will otherwise continue for claims outside the UK. The Preference Stock, the LSA, and the continuation of the existing indemnity for claims outside the UK work together to provide Visa Inc. with protection against liabilities from MIF litigation in the VE territory. Overall losses would in the first instance be recovered by VI from the banks in the form of cancelling the preference shares issued as part of the consideration above.

The potential exists, therefore, for the value of the Bank's consideration in the form of preference shares (Preference Stock) to be eroded by liabilities incurred by Visa Inc. in connection with MIF litigation in the VE territory.

Regulatory and other investigations
There are a number of 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. The investigation will review the conduct of relevant authorities (regulators and government) and the institution itself 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 Financial Reporting Council (FRC) has launched an investigation under its Accountancy Scheme into the preparation, approval and audit of the Bank's accounts up to and including its 2012 annual accounts, which focuses on the role of the previous auditors and individual accountants. The FRC concluded its investigations into the then CEO during 2016, and the investigation in relation to previous auditors and the audit of the 2012 and prior financial statements of the Bank is ongoing.

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 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 operating results, 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 31.

Mortgage securitisation representations and warranties
In connection with the Bank's mortgage securitisations and covered bond transactions described in note 38 to the Bank 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 31 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 remain in discussion to manage this by seeking agreement. There remain a number of possible solutions. 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.

It is not practicable to provide an estimate of the financial impact of this matter or what effect, if any, that these matters may have upon the Bank's operating results, cash flows or financial position in any period.

Separation from The Co-operative Group
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.

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.

Warwick Finance One and Two mortgage securitisation representations and warranties
In connection with the Bank's Warwick mortgage securitisation, the Bank makes various representations and warranties relating to the mortgage loans, which include 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 31 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.

35. Investment in joint ventures

The Bank's investment in joint ventures is £5.1m[1] (2015: £4.9m).

The Bank owns 49% and 50% of the ordinary shares in Britannia Personal Lending Limited (BPL) and Britannia New Homes (Scotland) Limited (BNH(S)) respectively, both registered in England and operating in the UK. BPL trades in the business of unsecured personal lending and BNH(S) trades in the construction of domestic buildings. Both are considered a joint venture as decisions about relevant activities require the unanimous consent of joint venturers.

The Bank's interest in BPL and BNH(S) is as follows:

	2016	Re-presented 2015
Current assets	**9.5**	8.1
Total Assets	**9.5**	8.1
Current liabilities	**4.4**	3.2
Equity[1]	**5.1**	4.9
Total Liabilities and Equity	**9.5**	8.1
Income	**0.6**	0.8
Expenses	**(0.2)**	(0.1)
Profit before tax	**0.4**	0.7
Taxation	**(0.1)**	-
Profit after tax	**0.3**	0.7

1. Britannia New Homes (Scotland) Limited has negative net assets and has not been accounted for using the equity method, therefore creating a difference between the primary financial statement line 'Investment in joint ventures' and the Equity line above.

The 2015 re-presentation is in relation to Total assets classification, where it was considered that prior year assets are more appropriately classified as Current assets.

Except as noted above, joint ventures are accounted for using the equity method.

36. Related party transactions

Parent, subsidiary and ultimate controlling party

The Bank's has three significant shareholders; Co-operative Banking Group Limited, a subsidiary of The Co-operative Group, holding over 20% of the Bank's shares and SP COOP Investments Limited and Golden Tree Asset Management funds each holding over 10% of the Bank's shares.

At 31 December 2016, the Bank is an associate of, and therefore a related party of, The Co-operative Group. As The Co-operative Group is a significant shareholder, it has the right to Bank Board representation and there are material transactions between the two companies.

Transactions with The Co-operative Group

Balances owed by The Co-operative Group to the Bank are shown below. In total these balances 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, therefore the Board considers that impairment is not required. Further details of shareholder relationship agreements with The Co-operative Group are shown in the Corporate Governance report.

The Chair of the Bank's Audit Committee and Non-Executive Director Glyn Smith is also a Non-Executive Director of a not-for-profit subsidiary of The Co-operative Group, Reclaim Fund Limited (RFL), from which The Co-operative Group and the Bank derives no financial benefit. Details of the relationship of the Bank with the Reclaim Fund are set out below.

Pensions Undertaking

The Co-operative Pension Scheme (Pace) and Britannia Pension Scheme are considered related parties due to the principal employer being The Co-operative Group and the Bank respectively.

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. Through 2016, the parties continue to discuss the separation of Pace and agree the Bank's proportion of employer contributions in Pace. See note 33 for further details.

Britannia Supplementary Pension & Life Assurance Plan (BSPLAP)

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

Britannia Pension Scheme

On 23 December 2015 the Bank entered into a deed of Amendment, Cessation, Substitution of Principal Employer, Apportionment, Augmentation and Release (the Deed) relating to the Britannia Pension Scheme with CFSMS and other parties. Under the Deed, the Bank agreed to become Principal Employer and Sponsor of the Britannia Pension Scheme in place of CFSMS with effect from 25 December 2015. In addition, the Bank was released from previous guarantees given in favour of the Scheme Trustees and also for the benefit of the Scheme.

Other services

The Co-operative Group and the Bank agreed a Professional Services Master Agreement and related Service Contracts to provide a range of corporate and HR services post-Separation (the Services). The majority of the services under the Services Agreement have now been repatriated to the Bank, with the intention that the they are formally terminated in 2017 and the final few remaining will be terminated in line with the completion of the IT Separation in 2018 (e.g. Datacenter Utility Services) or will be enduring arrangements depending on the Bank's business (e.g. Membership Services).

Separation costs agreement and IT services agreement

The Bank currently receives IT services from CGL under an IT Services Agreement (ITSA) dated 5 July 2012. The services are provided on at 'at costs' basis and the Bank manages CGL as a provider of material services. The most recent amendment to the ITSA was made on 21 December 2016 permitting termination, in part for convenience, and a framework to manage the process of exit of services from the ITSA to the Bank's new chosen suppliers. The Bank is now using this framework to exit progressively from the ITSA as services are transitioned from Co-operative Group to new suppliers. At this stage Bank anticipates completing exit of the IT Services Agreement during 2018.

The Bank and The Co-operative Group entered into an IT Separation Costs Agreement on 22 January 2015 as amended by a letter dated 20 June 2016 to support Separation of the legacy shared infrastructure. The IT Separation Costs agreement assessed the Bank and Co-operative Group's respective costs to deliver Separation. Co-operative Banking Group Limited (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. CGL and CSFMS undertook not to terminate the existing ITSA prior to 31 December 2017 to provide the Bank sufficient time to separate its IT infrastructure from that of CGL.

Transitional Services Letter (TSA)

CGL and Bank entered into a TSA on 21 Dec 2016 whereby CGL agreed to provide certain services to the Bank into the IBM environment to ensure a successful separation of the Bank's IT infrastructure from CGL.

CFSMS-Bank Framework Services Agreement

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 employment of the majority of the staff to the Bank and the transfer of assets to the Bank. The Bank entered into numerous contracts with third party suppliers to replace those services previously provided to the Bank through CFSMS or the wider The Co-operative Group. By the end of 2016 all known staff transfers had been completed and the vast majority of contracts re-established as 'Bank-only'. The remaining contracts will be transferred as they come due over the balance of the IT Separation period.

IT Security Services

The Bank's specialist IT security team provide an IT security service to the Bank and Co-operative Insurance Services General Insurance Limited (CISGIL) in relation to the shared IT infrastructure which the Bank and Co-operative Insurance Services General Insurance Limited (CISGIL) share until such infrastructure is separated. This service comprises a small number of people.

Following the TUPE transfer of IT security personnel from CFSMS to the Bank in November 2014, the Bank entered into a letter agreement with CFSMS that regulated the terms on which certain IT security personnel would have transferred from CFSMS to the Bank, and the terms on which the Bank would provide an IT security service that the transferred IT security personnel used to provide, in relation to the IT infrastructure which the Bank and CFSMS share.

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 and the terms of the payment by The Co-operative Group to the Bank for those tax losses. The 2016 Bank Financial Statements, which include a group relief debtor of £84.1m (2015: £60.1m), have been prepared on a basis consistent with the deed. The Bank receives payment from The Co-operative Group when The Co-operative Group realises the benefit of the losses surrendered and at the corporation tax rate at which the benefit is realised. These amounts are included within Other Assets.

Reclaim Fund Limited (RFL)

The Bank participates in the Dormant Accounts Scheme through its participation in RFL alongside many other banks and building societies in the UK. The Bank transfers balances on dormant accounts (those that have been dormant or inactive for 15 years or more) to RFL. RFL was established in 2011 to implement a significant part of the Dormant Bank & Building Society Accounts Act (the Act). It is a not-for-profit company operating under its own regulatory authorisation from the FCA with an independent board of directors. The Act allows the Bank to transfer money from its dormant accounts to RFL for distribution to the Big Lottery Fund for onward distribution to good causes across the UK. It also ensures that the rights of account holders are protected in perpetuity by transferring the claim against the Bank to RFL.

During the year the Bank transferred £1.1m to RFL from its dormant accounts (2015: £1.4m).

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 2016 and 31 December 2015 and their location within the Bank's balance sheet.

	2016			
	Loans and advances to customers	**Other assets**	**Customer accounts**	**Other liabilities**
The Co-operative Group Limited and its subsidiaries[1]	-	**84.2**	**(116.4)**	-
The Co-operative Banking Group Limited and its subsidiaries	-	**2.7**	**(1.7)**	-
	-	**86.9**	**(118.1)**	-

	2015			
	Loans and advances to customers	Other assets	Customer accounts	Other liabilities
The Co-operative Group Limited and its subsidiaries[1]	1.0	61.6	(100.1)	-
The Co-operative Banking Group Limited and its subsidiaries	-	19.2	(4.9)	(6.1)
	1.0	80.8	(105.0)	(6.1)

	2016		2015	
	Interest and fees received	**Interest and fees paid**	Interest and fees received	Interest and fees paid
The Co-operative Group Limited and its subsidiaries[1]	**2.3**	**0.7**	2.6	0.4
The Co-operative Banking Group Limited and its subsidiaries	**0.2**	**0.1**	0.3	-
	2.5	**0.8**	2.9	0.4

1. The Co-operative Group Limited and its subsidiaries excludes the Co-operative Banking Group Limited and its subsidiaries sub-group

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 2015, each of The Co-operative Banking Group Limited, SP Coop Investments Limited and Golden Tree Asset Management (via various Golden Tree funds) 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 Capital and Perry Capital 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). Therefore these are related parties.

Transactions with other related parties

Key management personnel, as defined by IAS 24 (Related Party Disclosures), are considered to be the Board of the Bank, and Board 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

	2016	2015
Loans outstanding at the beginning of the year	**-**	-
Net movement	**-**	-
Loans outstanding at the end of the year	**-**	-

Deposits and investments at the beginning of the year	**0.5**	0.2
Net movement	**0.7**	0.3
Deposits and investments at the end of the year	**1.2**	0.5

Directors' loans

	2016			2015		
	Mortgages	**Personal loans**	**Credit cards**	Mortgages	Personal loans	Credit cards
Number of directors with loan type	**-**	**-**	**-**	-	-	1
Total value of director loans	**-**	**-**	**-**	-	-	-

Key management compensation

	2016	2015
Salaries and short term benefits	**4.2**	4.6
Termination benefits	**-**	-
	4.2	4.6

37. Share capital

	2016		2015	
	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	**451.5**	**22.6**	451.5	22.6
At the end of the year	**451.5**	**22.6**	451.5	22.6

Share premium account		
At the beginning of the year	**1,736.9**	1,736.9
At the end of the year	**1,736.9**	1,736.9

The number of ordinary shares in issue at 31 December 2016 was 451,456,510 (2015: 451,456,510). The ordinary shareholders have one vote for every share held.

38. Fair values of financial assets and liabilities

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

Balance sheet categories	Held for trading	Designated at fair value	Loans and receivables	Available for sale	Liabilities at amortised cost	Derivatives in a hedging relationship	Total
2016							
Assets							
Cash and balances at central banks	-	-	2,848.2	-	-	-	2,848.2
Loans and advances to banks	-	-	836.9	-	-	-	836.9
Loans and advances to customers	4.1	188.9	19,259.7	-	-	-	19,452.7
Fair value adjustments for hedged risk	-	-	131.6	-	-	-	131.6
Investment securities	-	-	13.8	3,538.1	-	-	3,551.9
Derivative financial instruments	165.7	-	-	-	-	259.8	425.5
Equity shares	-	-	-	46.8	-	-	46.8
Other assets	-	-	96.7	-	-	-	96.7
Total financial assets	**169.8**	**188.9**	**23,186.9**	**3,584.9**	**-**	**259.8**	**27,390.3**
Non-financial assets							**198.0**
Total assets							**27,588.3**
Liabilities							
Deposits by banks	-	-	-	-	1,198.6	-	1,198.6
Customer accounts	-	-	-	-	22,425.1	-	22,425.1
Customer accounts – capital bonds	-	11.8	-	-	-	-	11.8
Debt securities in issue	-	-	-	-	1,625.4	-	1,625.4
Derivative financial instruments	194.6	-	-	-	-	249.9	444.5
Other borrowed funds	-	-	-	-	472.6	-	472.6
Other liabilities	-	-	-	-	45.9	-	45.9
Total financial liabilities	**194.6**	**11.8**	**-**	**-**	**25,767.6**	**249.9**	**26,223.9**
Non-financial liabilities							**405.9**
Total liabilities							**26,629.8**
Capital and reserves							**958.5**
Total liabilities and equity							**27,588.3**

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

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

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
2015							
Assets							
Cash and balances at central banks	-	-	2,678.5	-	-	-	2,678.5
Loans and advances to banks	-	-	871.0	-	-	-	871.0
Loans and advances to customers	4.2	174.0	19,512.2	-	-	-	19,690.4
Fair value adjustments for hedged risk	-	-	94.0	-	-	-	94.0
Investment securities	-	582.4	15.0	4,296.8	-	-	4,894.2
Derivative financial instruments	147.9	-	-	-	-	222.2	370.1
Equity shares	-	-	-	55.6	-	-	55.6
Other assets	-	-	124.1	-	-	-	124.1
Total financial assets	152.1	756.4	23,294.8	4,352.4	-	222.2	28,777.9
Non-financial assets							250.4
Total assets							29,028.3
Liabilities							
Deposits by banks	-	-	-	-	725.9	-	725.9
Customer accounts	-	-	-	-	22,732.0	-	22,732.0
Customer accounts – capital bonds	-	77.4	-	-	-	-	77.4
Debt securities in issue	-	-	-	-	2,554.3	-	2,554.3
Derivative financial instruments	148.1	-	-	-	-	198.8	346.9
Other borrowed funds	-	-	-	-	459.9	-	459.9
Other liabilities	-	-	-	-	68.8	-	68.8
Total financial liabilities	148.1	77.4	-	-	26,540.9	198.8	26,965.2
Non-financial liabilities							699.8
Total liabilities							27,665.0
Capital and reserves							1,363.3
Total liabilities and equity							29,028.3

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

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

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

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

In addition to this the Bank has issued notes additionally secured by mortgage assets through its Covered Bond programme and issued secured notes through a number of different securitisation SPEs, although a large number of these have matured in the year.

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

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

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

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

b) Valuation of financial assets and liabilities at fair value

The following tables analyse financial assets and liabilities carried at fair value by the three level fair value hierarchy defined as follows:

- Level 1 – Quoted market prices in active markets
- Level 2 – Valuation techniques using observable inputs
- Level 3 – Valuation techniques using unobservable inputs

	Fair value at end of the reporting period using:			
	Level 1	**Level 2**	**Level 3**	**Total**
2016				
Non-derivative financial assets				
Held for trading:				
Loans and advances to customers	**-**	**4.1**	**-**	**4.1**
Designated at fair value:				
Loans and advances to customers	**-**	**184.0**	**4.9**	**188.9**
Investment securities	**-**	**-**	**-**	**-**
Available for sale financial assets:				
Investment securities	**2,230.7**	**-**	**1,307.4**	**3,538.1**
Equity shares	**0.2**	**27.3**	**19.3**	**46.8**
Derivative financial assets	**-**	**425.5**	**-**	**425.5**
Non-financial assets:				
Investment properties	**-**	**-**	**2.2**	**2.2**
Total assets carried at fair value	**2,230.9**	**640.9**	**1,333.8**	**4,205.6**
Non-derivative financial liabilities				
Designated at fair value:				
Customer accounts – capital bonds	**-**	**11.8**	**-**	**11.8**
Derivative financial liabilities	**-**	**444.5**	**-**	**-**
Total liabilities carried at fair value	**-**	**456.3**	**-**	**456.3**

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

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

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

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

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

Loans and advances to customers
Loans and advances to customers primarily relate to corporate loans of £178.1m (2015: £159.1m), which are fair valued through profit or loss using observable inputs. Loans held at fair value are valued at the sum of all future expected cash flows, discounted using a yield curve based on observable market inputs.

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

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

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

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

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

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

Loans and advances to customers
Loans and advances to customers include 25 year fixed rate mortgages of £4.9m (2015: £5.5m), which are fair valued through profit or loss using unobservable inputs. 25 year fixed rate mortgages are valued using future interest cash flows at the fixed customer rate and estimated schedule of customer repayments. Cash flows are discounted at a credit adjusted discount rate; the credit adjustment is based on the average margin of new long dated (five years or greater) fixed rate business written in the last six months, and subject to quarterly review. The eventual timing of future cash flows may be different from that forecast due to unpredictable customer behaviour, particularly on a 25 year product. The valuation methodology takes account of credit risk and has increased the valuation by £0.2m in 2016 (2015: £0.2m decrease). A reasonable change in the assumptions would not result in any material change in the valuation.

Investment securities – available for sale
Investment securities – available for sale include MBS of £1,307.4m (2015: £1,599.8m), which are fair valued through other comprehensive income. The Bank uses an independent third party valuation agent which provides prices obtained from large financial institutions. These prices are indicative values only and do not represent an offer to purchase the securities.

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

A 1% increase or decrease in the price of the notes will result in the value increasing or decreasing by approximately £13.0m respectively.

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

If the illiquidity premium to the discount rate was assumed to be double, it would result in a reduction in the overall fair value of the equity shares of £3.5m (18.1%) at 31 December 2016. Therefore, this valuation model is not deemed to be materially sensitive to this input, with a 100% increase resulting in an 18.1% change in valuation.

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

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

	Fair value at the beginning of the year	**Purchases and transfers in**	**Sales, transfers out and repayments**	**Other comprehensive income**	**Income statement**	**Fair value at the end of the year**
2016						
Loans and advances to customers	**5.5**	**-**	**(0.8)**	**-**	**0.2**	**4.9**
Investment securities	**1,599.8**	**-**	**(306.5)**	**9.0**	**5.1**	**1,307.4**
Equity shares	**51.2**	**16.1**	**(58.2)**	**13.5**	**(3.3)**	**19.3**
Investment properties	**2.1**	**-**	**(0.1)**	**-**	**0.2**	**2.2**
	1,658.6	**16.1**	**(365.6)**	**22.5**	**2.2**	**1,333.8**
2015						
Loans and advances to customers	6.7	-	(1.0)	-	(0.2)	5.5
Investment securities	-	1,685.5	(86.8)	1.1	-	1,599.8
Equity shares	-	-	-	51.2	-	51.2
Investment properties	2.1	-	(0.1)	-	0.1	2.1
	8.8	1,685.5	(87.9)	52.3	(0.1)	1,658.6

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

Fair values are determined according to the hierarchy set out above.

	Carrying value	Fair Value Level 1	Fair Value Level 2	Fair Value Level 3
2016				
Financial assets				
Cash and balances at central banks	**2,848.2**	**-**	**2,848.2**	**-**
Loans and advances to banks	**836.9**	**-**	**836.9**	**-**
Loans and advances to customers	**19,259.7**	**-**	**-**	**18,748.0**
Fair value adjustment for hedged risk	**131.6**	**-**	**-**	**131.6**
Investment securities	**13.8**	**12.8**	**-**	**-**
Financial liabilities				
Deposits by banks	**1,198.6**	**-**	**1,198.6**	**-**
Customer accounts	**22,425.1**	**-**	**16,296.2**	**6,172.6**
Debt securities in issue	**1,625.4**	**1,058.8**	**663.6**	**-**
Other borrowed funds	**472.6**	**-**	**363.6**	**-**

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

	Carrying value	Fair Value Level 1	Fair Value Level 2	Fair Value Level 3
Re-presented 2015				
Financial assets				
Cash and balances at central banks	2,678.5	-	2,678.5	-
Loans and advances to banks	871.0	-	871.0	-
Loans and advances to customers	19,512.2	-	-	19,204.8
Fair value adjustment for hedged risk	94.0	-	-	94.0
Investment securities	15.0	13.3	-	-
Financial liabilities				
Deposits by banks	725.9	-	725.9	-
Customer accounts	22,732.0	-	22,737.0	-
Debt securities in issue	2,554.3	1,307.3	1,575.4	-
Other borrowed funds	459.9	-	498.7	-

The level disclosures for debt securities in issue have been re-presented to better reflect how the fair value was determined.

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

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

Carrying value	Core				Non-core				
	Retail	BaCB	Treasury	Total Core	Legacy Portfolio	Optimum	Total Non-core	Unallocated	Total
2016									
Financial assets									
Cash and balances at central banks	-	-	2,848.2	2,848.2	-	-	-	-	2,848.2
Loans and advances to banks	-	-	836.9	836.9	-	-	-	-	836.9
Loans and advances to customers	14,858.9	498.0	-	15,356.9	1,297.0	2,605.8	3,902.8	-	19,259.7
Fair value adjustments to hedged risk	131.6	-	-	131.6	-	-	-	-	131.6
Investment securities	-	-	13.8	13.8	-	-	-	-	13.8
Other assets	-	-	-	-	-	-	-	96.7	96.7
Financial liabilities									
Deposits by banks	-	-	1,198.6	1,198.6	-	-	-	-	1,198.6
Customer accounts	19,528.7	2,731.3	-	22,260.0	165.1	-	165.1	-	22,425.1
Debt securities in issue	-	-	1,625.4	1,625.4	-	-	-	-	1,625.4
Other borrowed funds	-	-	472.6	472.6	-	-	-	-	472.6
Other liabilities	-	-	-	-	-	-	-	45.9	45.9

Fair value	Core				Non-core				
	Retail	BaCB	Treasury	Total Core	Legacy Portfolio	Optimum	Total Non-core	Unallocated	Total
2016									
Financial assets									
Cash and balances at central banks	-	-	2,848.2	2,848.2	-	-	-	-	2,848.2
Loans and advances to banks	-	-	836.9	836.9	-	-	-	-	836.9
Loans and advances to customers	14,794.8	461.4	-	15,256.2	1,154.0	2,337.8	3,491.8	-	18,748.0
Fair value adjustments to hedged risk	131.6	-	-	131.6	-	-	-	-	131.6
Investment securities	-	-	12.8	12.8	-	-	-	-	12.8
Other assets	-	-	-	-	-	-	-	96.7	96.7
Financial liabilities									
Deposits by banks	-	-	1,198.6	1,198.6	-	-	-	-	1,198.6
Customer accounts	19,572.4	2,731.3	-	22,303.7	165.1	-	165.1	-	22,468.8
Debt securities in issue	-	-	1,722.4	1,722.4	-	-	-	-	1,722.4
Other borrowed funds	-	-	363.6	363.6	-	-	-	-	363.6
Other liabilities	-	-	-	-	-	-	-	45.9	45.9

Carrying value	Core				Non-core				
	Retail	BaCB	Treasury	Total Core	Legacy Portfolio	Optimum	Total Non-core	Unallocated	Total
2015									
Financial assets									
Cash and balances at central banks	-	-	2,678.5	2,678.5	-	-	-	-	2,678.5
Loans and advances to banks	-	-	871.0	871.0	-	-	-	-	871.0
Loans and advances to customers	14,257.1	576.5	-	14,833.6	1,817.3	2,861.3	4,678.6	-	19,512.2
Fair value adjustments to hedged risk	98.0	-	-	98.0	(4.0)	-	(4.0)	-	94.0
Investment securities	-	-	15.0	15.0	-	-	-	-	15.0
Other assets	-	-	-	-	-	-	-	124.1	124.1
Financial liabilities									
Deposits by banks	-	-	725.9	725.9	-	-	-	-	725.9
Customer accounts	19,838.7	2,682.0	-	22,520.7	211.3	-	211.3	-	22,732.0
Debt securities in issue	-	-	2,554.3	2,554.3	-	-	-	-	2,554.3
Other borrowed funds	-	-	459.9	459.9	-	-	-	-	459.9
Other liabilities	-	-	-	-	-	-	-	68.8	68.8

Fair value	Core				Non-core				
	Retail	BaCB	Treasury	Total Core	Legacy Portfolio	Optimum	Total Non-core	Unallocated	Total
2015									
Financial assets									
Cash and balances at central banks	-	-	2,678.5	2,678.5	-	-	-	-	2,678.5
Loans and advances to banks	-	-	871.0	871.0	-	-	-	-	871.0
Loans and advances to customers	14,429.3	559.5	-	14,988.8	1,659.4	2,556.6	4,216.0	-	19,204.8
Fair value adjustments to hedged risk	98.0	-	-	98.0	(4.0)	-	(4.0)	-	94.0
Investment securities	-	-	13.3	13.3	-	-	-	-	13.3
Other assets	-	-	-	-	-	-	-	124.1	124.1
Financial liabilities									
Deposits by banks	-	-	725.9	725.9	-	-	-	-	725.9
Customer accounts	19,842.2	2,683.5	-	22,525.7	211.3	-	211.3	-	22,737.0
Debt securities in issue	-	-	2,882.7	2,882.7	-	-	-	-	2,882.7
Other borrowed funds	-	-	498.7	498.7	-	-	-	-	498.7
Other liabilities	-	-	-	-	-	-	-	68.8	68.8

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

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

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

Loans and advances to customers
The fair value of loans and advances to customers in total is 97% of the carrying value as at 31 December 2016 (2015: 98%). This decrease in the period has been partially as a result of a change in estimation technique used to measure the fair value of the Bank's loans and advances to customers.

The overall fair value is less than par primarily due to two main factors for Non-core loans in particular:

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

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

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

Other reporting entities may use different valuation methodologies and assumptions in determining fair values for which no observable market prices are available.

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

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

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

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

Unwind of merger fair value adjustments

On the merger of the Bank and Britannia Building Society in August 2009 an exercise was undertaken to fair value the respective assets and liabilities of Britannia Building Society. These fair value adjustments are unwound on an EIR basis over the expected lives of the assets and liabilities. As at 31 December 2016, 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 2016	Forecast unwind			
				2017	2018	2019	2020+
2016							
Assets							
Loans and advances to customers	**19,452.7**	**(16.5)**	**(5.1)**	**(1.9)**	**(1.6)**	**(1.4)**	**(11.6)**
Fair value adjustment for hedged risk	**131.6**	**(6.3)**	**(3.5)**	**(1.5)**	**(1.2)**	**(0.8)**	**(2.8)**
Other	**8,004.0**	**12.5**	**8.0**	**4.3**	**4.3**	**2.5**	**1.4**
Total assets	**27,588.3**	**(10.3)**	**(0.6)**	**0.9**	**1.5**	**0.3**	**(13.0)**
Liabilities							
Debt securities in issue	**1,625.4**	**(58.3)**	**(176.8)**	**(58.3)**	**-**	**-**	**-**
Deferred tax liabilities	**14.2**	**11.7**	**33.2**	**11.4**	**(0.1)**	**(0.1)**	**0.5**
Other	**24,990.2**	**-**	**-**	**-**	**-**	**-**	**-**
Total liabilities	**26,629.8**	**(46.6)**	**(143.6)**	**(46.9)**	**(0.1)**	**(0.1)**	**0.5**

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

Issue name	Issue date	Expected 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 2016	Forecast unwind 2017
2016							
Leek Finance Number Seventeen plc	**April 2006**	**Matured**	**-**	**-**	**-**	**29.5**	**-**
Leek Finance Number Eighteen plc	**October 2006**	**Matured**	**-**	**-**	**-**	**72.0**	**-**
Leek Finance Number Nineteen plc	**April 2007**	**June 2017**	**689.1**	**711.6**	**58.9**	**78.1**	**58.9**
Total Leek Notes			**689.1**	**711.6**	**58.9**	**179.6**	**58.9**

Of which, liabilities held internally within the Bank, that eliminate against the gross balances above, 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 2016	Forecast unwind 2017
2016					
Internally held Leek Notes	**189.2**	**189.7**	**0.6**	**2.8**	**0.6**

d) Fair value of transferred assets and associated liabilities

Securitisation vehicles

The sale of the loans and advances to customers to securitisation vehicles by the subsidiaries of the Bank fails 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, and when the securitisation's unwind.

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 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, on account of holding subordinated notes issued by the securitisation vehicles.

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. As some of these issued notes are held internally by the Bank, they are not shown in the consolidated balance sheet of the Bank.

	Carrying amount of transferred assets not derecognised	Carrying amount of associated liabilities	Fair value of transferred assets not derecognised	Fair value of associated liabilities	Net fair value position
2016					
Leek Finance Number Seventeen plc[1]	-	-	-	-	-
Leek Finance Number Eighteen plc[1]	-	-	-	-	-
Leek Finance Number Nineteen plc	**577.4**	**689.1**	**539.2**	**711.6**	**(172.4)**
Silk Road Finance Number Three plc[1]	-	-	-	-	-
Meerbrook Finance Number Eight Ltd[1]	-	-	-	-	-
	577.4	**689.1**	**539.2**	**711.6**	**(172.4)**

1. Leek 17, Leek 18, Silk Road 3 and Meerbrook 8 are nil at 31 December 2016 because these securitisations unwound during 2016.

The above carrying amount of associated liabilities can be reconciled to debt securities in issue, as follows:

	Carrying value
Carrying amount of associated liabilities as given above	**689.1**
Internally held fixed and floating rate notes	**(189.2)**
Loan facilities and subdebt not included in debt securities in issue	**24.6**
Non-securitised debt securities	**1,123.7**
Merger fair value adjustment	**(58.3)**
Other adjustments	**35.5**
Debt securities in issue per consolidated balance sheet	**1,625.4**

Of the notes listed above, those held by the Bank are as follows:

	Carrying amount of transferred assets not derecognised	Carrying amount of associated liabilities	Fair value of transferred assets not derecognised	Fair value of associated liabilities	Net fair value position
2016					
Leek Finance Number Seventeen plc	-	-	-	-	-
Leek Finance Number Eighteen plc	-	-	-	-	-
Leek Finance Number Nineteen plc	**158.5**	**189.2**	**195.4**	**189.7**	**5.7**
Silk Road Finance Number Three plc	-	-	-	-	-
	158.5	**189.2**	**195.4**	**189.7**	**5.7**

The above carrying value and fair value of assets held for each entity has been determined by applying the proportion of internally held liabilities.

Transferred assets include securitised gilts and loans and advances to customers that have not been derecognised by the seller. The associated liabilities include the fixed and floating rate notes, bank loans and intercompany loans that specifically relate to the funding for the assets securitised.

The fair value to carrying value ratio of the mortgages that have been securitised within Leek 19 is lower than the fair value to carrying value ratio for the associated liabilities. This is because it is expected that the notes will be repaid at par at the call date of the Leek liabilities, whereas most of the mortgages will continue to be held on the Bank's balance sheet for a significant period after the notes have been repaid and these mortgages have an interest rate which is below the equivalent market rate at the balance sheet date for loans of a similar nature.

The securitisation vehicles receive cash daily in relation to the transferred loans and advances and semi-annually for the transferred gilts. These amounts are held within loans and advances to banks until the associated liabilities' payments are due. Payments are made quarterly for all associated liabilities except for the variable funding notes associated with the transferred gilts, which are paid semi-annually. The amounts held within loans and advances to banks are not included in the table above but will be used in part to cover the repayments made on the associated liabilities.

The following table provides the fair value of the transferred assets and associated liabilities for 2015:

	Carrying amount of transferred assets not derecognised	Carrying amount of associated liabilities	Fair value of transferred assets not derecognised	Fair value of associated liabilities	Net fair value position
2015					
Leek Finance Number Seventeen plc	525.1	536.0	497.1	548.7	(51.6)
Leek Finance Number Eighteen plc	633.3	687.3	615.4	698.5	(83.1)
Leek Finance Number Nineteen plc	617.0	676.1	600.0	681.2	(81.2)
Silk Road Finance Number Three plc	343.9	351.2	342.7	350.6	(7.9)
Meerbrook Finance Number Eight Ltd	377.7	364.0	379.5	366.6	12.9
	2,497.0	2,614.6	2,434.7	2,645.6	(210.9)

Covered Bond Limited Liability Partnerships

Moorland Covered Bonds LLP was established as a result of a £1.4bn covered bond retained issuance. Loans and advances to customers of £1.9bn were transferred to Moorland Covered Bonds LLP. The transfer was funded by a loan of £1.4bn and capital contribution of £0.5bn. During October 2011 the £1.4bn loan was repaid. Following additional capital contribution repayment and on achieving Regulated Covered Bond status there was a public issuance of notes in November 2011 totalling £0.6bn. At the period end the Bank held a loan of £0.6bn (2015: £0.6bn) and a capital contribution of £0.6bn (2015: £0.6bn) with Moorland Covered Bonds LLP.

Moorland Covered Bonds LLP does not have ordinary share capital. The Bank's interest in Moorland Covered Bonds LLP is in substance no different from a wholly owned subsidiary and consequently it is fully consolidated in the Bank's accounts. The table below shows the carrying values and fair values of the assets transferred to the covered bond and their associated liabilities:

	Carrying amount of transferred loans and advances to customers	**Carrying amount of fixed and floating rate notes**	**Fair value of transferred loans and advances to customers**	**Fair value of fixed and floating rate notes**	**Net fair value position**
2016					
Moorland Covered Bonds LLP	**1,208.5**	**597.4**	**1,188.9**	**669.8**	**519.1**
2015					
Moorland Covered Bonds LLP	1,215.4	596.9	1,222.6	668.1	554.5

Assets pledged

Assets are pledged as collateral under repurchase agreements with other banks. These deposits are not available to finance the Bank's day-to-day operations.

	Carrying amount of assets not derecognised	**Carrying amount of associated liabilities**	**Fair value of assets not derecognised**	**Fair value of associated liabilities**	**Net fair value position**
2016					
Investments securities sold under repurchase agreements	**1,260.1**	**1,169.3**	**1,260.1**	**1,169.3**	**90.8**
2015					
Investments securities sold under repurchase agreements	721.7	671.2	721.7	671.2	50.5

Associated liabilities are included within deposits by banks.

Assets sold under repurchase agreements include mortgage backed securities (£426.5m of assets and associated liabilities of £336.1m) and UK government gilts (£833.6m of assets and associated liabilities of £833.2m).

39. Share-based payments

The Bank has made grants to senior employees in the year under the Long Term Incentive Plan (LTIP). A grant as a proportion of employee's salary is denominated in notional shares using the Bank's grey market share price at the time of award and the Transitional Deferral Awards Plan (TDAP). They are cash settled with performance based vesting conditions over a period of 3 years, and a further 2 year holding period for 2015 Plan and additional Performance test at year 5 for the 2016 Plan, with other non-vesting conditions. Awards are subject to malus and clawback in accordance with regulatory requirements. As cash settled share based payment arrangements, the services acquired and the liability incurred are measured at the fair value of the liability and recognised as employees render services, as required by IFRS 2. Until settlement, the fair value of the liability is remeasured over the vesting period.

The performance measures and any restrictions that apply are set out in more detail in the Directors' Remuneration Report.

25% of the awards will vest contingent on market based performance measures being met, and such market based conditions are required to be included in the estimation of fair value. Accordingly the fair value of these grants has been determined using a Monte Carlo option pricing model.

The remaining 75% of awards are subject to non-market based performance measures and, in accordance with IFRS 2, are not required to be incorporated into the calculation of fair value. Therefore the fair value is simply equal to the share price at the reporting date (£0.38).

The release to the income statement in 2016 for the Bank was £0.3m (2015: £0.8m charge) inclusive of National Insurance.

The fair value of the award subject to market based performance measures and the assumptions used in determining the fair value are as follows.

	LTIP 2016	LTIP 2015
Grant date	**23/12/2016**	18/06/2015
Grey share price at grant date	**£0.61**	£2.28
Notional shares awarded with market based performance measures	**3,647,096**	1,020,318
Vesting period	**3 years**	3 years
Expected volatility	**29.8%**	30.9%
Expected term remaining	**5 years**	4 years
Exercise price	**nil**	nil
Risk free rate	**0.36%**	0.19%
Fair value per award	**£0.13**	nil

Expected volatility was based on the historical volatility of similar listed entities. The risk free interest rate was based on zero coupon UK government bonds as at the date of grant with similar remaining term to the expected life of the awards

For TDAP, a grant as a proportion of employee's salary is denominated in notional shares using the Bank's grey market price. They are cash settled with a performance based vesting condition over a period of 4 years, and a further 6 month holding period. Awards are subject to malus and clawback in accordance with regulatory requirements. As cash settled share based payment arrangements, the services acquired and the liability incurred are measured at the fair value of the liability and recognised as employees render services, as required by IFRS 2. Until settlement, the fair value of the liability is remeasured over the vesting period.

The performance measures and any restrictions that apply are set out in more detail in the Directors' Remuneration Report.

The award is subject to a non-market based performance measure and, in accordance with IFRS 2, is not required to be incorporated into the calculation of fair value. Therefore fair value is simply equal to the share price at the reporting date (£0.41).

The release to the income statement in 2016 for the Bank was £0.1m (2015: £0.1m charge), inclusive of National Insurance.

A reconciliation of the grants outstanding during the year is as follows.

	Number of notional shares LTIP	**Number of notional shares TDAP**
Outstanding at the beginning of the year	**4,081,273**	147,632
Granted during the year	**14,588,384**	-
Forfeited during the year	**(4,627,269)**	-
Exercised during the year	**-**	-
Expired during the year	**-**	-
Outstanding at the end of the year	**14,042,388**	147,632

The conditional entitlements outstanding under the schemes at 31 December 2016 were:

Award	**Grant date**	**Vesting period**	**Expected settlement date**	**Number 2016**	Number 2015
TDAP	June 2015	3 years	June 2019	**147,632**	147,632
LTIP	June 2015	3 years	March 2020	**3,497,720**	4,081,273
LTIP	September 2016	5 years	March 2021	**10,544,668**	-

40. Interests in unconsolidated structured entities

The table below shows only the continuing involvement the Bank retains in two unconsolidated SPEs, being senior Notes issued by the SPEs. These notes are reported as Investment Securities - Available for Sale. The maximum exposure to loss is the carrying value of these Notes.

	Carrying amount of continuing involvement in statement of financial position		**Fair value of continuing involvement**		**Maximum exposure to loss**
	Assets £m	**Liabilities £m**	**Assets £m**	**Liabilities £m**	**£m**
31 December 2016	**1,307.4**	**-**	**£1,307.4**	**-**	**£1,307.4**

	Carrying amount of continuing involvement in statement of financial position		Fair value of continuing involvement		Maximum exposure to loss
	Assets £m	Liabilities £m	Assets £m	Liabilities £m	£m
31 December 2015	1,599.8	-	1,599.8	-	1,599.8

	Gain or loss recognised at transfer date £m	**Gain or loss recognised on sale £m**	**Interest income/(expense) recognised in the year £m**	**FV movement recognised in OCI £m**	**Income/(expense) recognised cumulatively £m**
31 December 2016	**-**	**0.5**	**31.4**	**9.0**	**31.9**

	Gain or loss recognised at transfer date £m	**Gain or loss recognised on sale £m**	Interest income/(expense) recognised in the year £m	FV movement recognised in OCI £m	Income/(expense) recognised cumulatively £m
31 December 2015	(43.4)	-	13.4	0.2	(29.8)

The assets in the table above represent the Bank's continuing involvement in securitisations where the Bank has transferred assets to an unconsolidated SPE, but has retained some of the notes issued by the SPE. These notes are reported in Investment securities - available for sale. The maximum exposure to loss is the carrying amount of the notes.

The Bank also has a requirement to fund any Conduct Redress for the mortgages. The Bank has currently funded £2.6m however anything above/below this figure will be due from/back to the Bank.

41. Events after the balance sheet date

- The Bank announced on 26 January 2017 that it expected its CET1, in the absence of any management actions, to fall and remain below 10% over the medium term. It is also unlikely to meet its Individual Capital Guidance (ICG) over the planning period to 2020. The Bank expects to meet its Pillar 1 capital requirements and to maintain sufficient liquidity to meet its obligations.

- On 13 February 2017 the Bank announced that it was commencing a full sale process, inviting offers for 100% of its issued share capital and was also considering other options to build capital and meet the longer term capital requirements applicable to all UK Banks. Further details are set out in the Strategic report to the Bank Annual Report and Accounts.

- Effective 10 February 2017, the Bank agreed amended contractual arrangements with its outsourced mortgage provider, and accordingly provisions for associated liabilities have been recognised in the financial statements.

THE COMPANY FINANCIAL STATEMENTS

The Company balance sheet

As at 31 December 2016

All amounts are stated in £m unless otherwise indicated

	Note	2016	Restated 2015[1]
Assets			
Cash and balances at central banks	4	**2,848.2**	2,670.1
Loans and advances to banks	5	**619.1**	452.1
Loans and advances to customers	6a	**19,293.4**	12,481.1
Fair value adjustments for hedged risk	6b	**131.6**	94.0
Investment securities - loans and receivables	7a	**34.8**	66.1
Investment securities - available for sale	7b	**3,538.1**	4,296.8
Investment securities - fair value through profit or loss	7c	**-**	582.4
Derivative financial instruments	8	**261.2**	193.2
Non-current assets classified as held for sale	3	**5.3**	3.4
Equity shares	9	**44.8**	53.7
Investments in subsidiaries/Group undertakings	24	**806.8**	1,214.4
Investment properties	11	**2.2**	2.1
Property, plant and equipment	12	**31.8**	42.2
Intangible assets	10	**100.1**	142.8
Amounts owed by other Co-operative Bank undertakings	25	**1,106.3**	8,322.8
Other assets	13	**148.9**	192.8
Prepayments and accrued income	14	**28.7**	43.5
Deferred tax assets	22	**1.6**	2.0
Net retirement benefit asset		**20.3**	-
Total assets		**29,023.2**	30,855.5

	Note	2016	Restated 2015[1]
Liabilities			
Deposits by banks	15	**1,198.6**	715.9
Customer accounts		**22,558.5**	23,135.3
Customer accounts - capital bonds	16	**11.8**	77.4
Debt securities in issue	17	**1,006.8**	1,005.7
Derivative financial instruments	8	**495.8**	403.2
Other borrowed funds	18	**472.6**	459.9
Amounts owed to other Co-operative Bank undertakings	25	**2,141.0**	3,186.4
Other liabilities	19	**44.9**	44.8
Accruals and deferred income	20	**91.3**	126.2
Provisions for liabilities and charges	21	**275.5**	458.5
Current tax liabilities		**-**	0.3
Total liabilities		**28,296.8**	29,613.6

	Note	2016	Restated 2015[1]
Capital and reserves attributable to the Company's equity holders			
Ordinary share capital	26	**22.6**	22.6
Share premium account	26	**1,736.9**	1,736.9
Retained earnings		**(1,547.2)**	(1,017.8)
Available for sale reserve		**38.2**	55.6
Capital redemption reserve		**410.0**	410.0
Cash flow hedging reserve		**56.4**	34.6
Defined benefit pension reserve		**9.5**	-
Total equity		**726.4**	1,241.9
Total liabilities and equity		**29,023.2**	30,855.5

1. See note 1 to the Company financial statements for details of the restatement

Net loss attributable to equity shareholders of the Company is £529.4m (2015: £497.0m).

The notes on pages 226 to 251 form part of these financial statements.

Approved by the Board on 8 March 2017:

Dennis Holt, Chairman

Liam Coleman, Chief Executive

John Worth, Chief Financial Officer

The Company statement of cash flows
For the year ended 31 December 2016
All amounts are stated in £m unless otherwise indicated

	2016	Restated 2015[1]
Cash flows used in operating activities:		
Loss before taxation	**(556.1)**	(500.0)
Adjustments for:		
Decrease/(increase) in prepayments and accrued income	**14.8**	(31.7)
(Decrease)/increase in accruals and deferred income	**(34.9)**	113.9
Interest payable in respect of other borrowed funds	**43.9**	28.6
Effect of exchange rate movements	**(10.9)**	2.5
Fair value of movements on investment properties	**(0.2)**	-
Losses/(gains) on loans and advances	**41.9**	(29.1)
Fair value movement on loans and advances	**8.1**	-
Depreciation and amortisation	**40.9**	39.2
Interest amortisation	**(13.6)**	3.4
Fair value movements and amortisation of financial assets and liabilities	**(82.1)**	38.8
Profit on disposal of investment securities	**(18.4)**	-
Impairment of property, plant and equipment	**1.0**	-
Impairment of intangible fixed assets	**40.6**	0.3
Gains on disposal of property, plant, equipment and software	**(4.8)**	(3.0)
Loss on sale of loans and advances to customers	**7.2**	-
Net loss on sale of subsidiaries	**-**	5.0
Net impairment/(write back) of investment in subsidiaries	**538.9**	(137.8)
Dividends received	**(320.9)**	-
Unwind of fair value adjustments arising on transfer of engagements	-	(9.4)
	(304.6)	(479.3)
Increase in deposits by banks	**482.7**	110.8
Decrease in customer accounts and capital bonds	**(642.4)**	(5,871.5)
Increase/(decrease) in debt securities in issue	**1.1**	(427.4)
(Increase)/decrease in loans and advances to banks	**(174.2)**	15.9
(Increase)/decrease in loans and advances to customers	**(6,858.7)**	3,524.2
Decrease in amounts owed by Co-operative Bank undertakings	**7,216.5**	4,404.2
Decrease in amounts owed to Co-operative Bank undertakings	**(1,045.4)**	(2,846.6)
Net movement of other assets and other liabilities	**(89.0)**	122.9
Income tax received/(paid)	**0.4**	(0.1)
Net cash flows used in operating activities	**(1,413.6)**	(1,446.9)

Cash flows from/(used in) investing activities:		
Purchase of tangible and intangible fixed assets	**(40.3)**	(79.7)
Proceeds from sale of fixed assets	**16.3**	21.1
Purchase of investment securities	**(363.7)**	(1,918.7)
Proceeds from sale of equity shares	**41.8**	-
Proceeds from sale and maturity of investment securities	**1,784.7**	1,054.5
Net movement on investments in Co-operative Bank undertakings	**(131.3)**	(153.8)
Profit from sales of subsidiaries	**-**	5.9
Dividends received	**320.9**	-
Net cash flows from/(used in) investing activities	**1,628.4**	(1,070.7)

Cash flows (used in)/from financing activities:		
Interest paid on other borrowed funds	**(43.9)**	(28.6)
Issuance of other borrowed funds	**-**	249.0
Net cash flows (used in)/from financing activities	**(43.9)**	220.4

	Note	2016	Restated 2015[1]
Increase/(decrease) in cash and cash equivalents		**170.9**	(2,297.2)
Cash and cash equivalents at the beginning of the financial year		**3,076.7**	5,373.9
Cash and cash equivalents at the end of the financial year		**3,247.6**	3,076.7
Cash and balances with central banks	4	**2,807.2**	2,624.6
Loans and advances to banks	5	**440.4**	452.1
		3,247.6	3,076.7

1. See note 1 to the Company financial statements for details of the restatement

The notes on pages 226 to 251 form part of these financial statements.

The Company statement of changes in equity
For the year ended 31 December 2016
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**	**Defined benefit pension scheme**	**Retained earnings**	**Total equity**
2016								
Balance at the beginning of the year	**22.6**	**1,736.9**	**55.6**	**34.6**	**410.0**	**-**	**(1,017.8)**	**1,241.9**
Total comprehensive (expense)/income for the year	**-**	**-**	**(17.4)**	**21.8**	**-**	**9.5**	**(529.4)**	**(515.5)**
Balance at the end of the period	**22.6**	**1,736.9**	**38.2**	**56.4**	**410.0**	**9.5**	**(1,547.2)**	**726.4**

	Attributable to equity holders of the Company							
	Share capital	Share premium	Available for sale reserve	Cash flow hedging reserve	Capital redemption reserve	Defined benefit pension scheme	Retained earnings	Total equity
2015 Restated[1]								
Balance at the beginning of the period	22.6	1,736.9	24.7	59.0	410.0	-	(520.8)	1,732.4
Total comprehensive (expense)/income for the period	-	-	30.9	(24.4)	-	-	(497.0)	(490.5)
Balance at the end of the period	22.6	1,736.9	55.6	34.6	410.0	-	(1,017.8)	1,241.9

1. See note 1 to the Company financial statements for details of the restatement

The notes on pages 226 to 251 form part of these financial statements.

NOTES TO THE COMPANY FINANCIAL STATEMENTS

1. Company restatement

As at 31 December 2015 the Company held a receivable of £427.8m from Mortgage Agency Services Number One Limited (MAS 1), an indirect subsidiary undertaking, which it had historically impaired by £127.8m to £300.0m as a result of MAS1 being in a net liability position.

During 2015 MAS 1 was recapitalised by its parent company, Britannia Treasury Services Limited. During 2016, the Company has reviewed its receivables from Bank subsidiaries and determined that this loan was not impaired as at 31 December 2015 once the 2015 recapitalisation had been taken into account and accordingly has restated the loan value to exclude impairment.

The effect of the restatement was to increase amounts owed by other Co-operative Bank undertakings by £127.8m and increase retained earnings by £127.8m.

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.

	2016	Restated 2015
Net loss attributable to equity shareholders of the Company	**(529.4)**	(497.0)

3. Non-current assets classified as held for sale

	2016	2015
Property, plant and equipment	**5.3**	3.4
Total	**5.3**	3.4

4. Cash and balances at central banks

	2016	2015
Cash in hand	**50.5**	54.7
Balances with the Bank of England other than mandatory reserve deposits	**2,756.7**	2,569.9
Included in cash and cash equivalents	**2,807.2**	2,624.6
Mandatory reserve deposits with the Bank of England	**41.0**	45.5
	2,848.2	2,670.1

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

	2016	2015
Items in course of collection from other banks	**9.6**	18.3
Placements with other banks	**430.8**	433.8
Included in cash and cash equivalents	**440.4**	452.1
Other loans and advances to banks	**178.7**	-
	619.1	452.1

6. a) Loans and advances to customers

	2016	2015
Gross loans and advances	**19,421.7**	12,709.8
Less: allowance for losses	**(128.3)**	(228.7)
	19,293.4	12,481.1

Loans and advances to customers include £188.9m (2015: £174.0m) of financial assets at fair value through profit or loss designated at initial recognition to eliminate or significantly reduce a measurement or recognition inconsistency, and £4.1m (2015: £4.2m) of financial assets held for trading. Of these, £118.5m (2015: £103.9m) are secured by real estate collateral.

Loans and advances to customers include £1.8bn (2015: £3.2bn) securitised under the Company's securitisation and covered bond programmes. The Company remains exposed to substantially all of the risks and rewards of ownership of these assets. Secured on these mortgage assets are £nil (2015: £10.1m) of deposits by banks and £1.1bn (2015: £2.3bn) of fixed and floating rate notes.

Allowance for losses on loans and advances

	Core		Non-core		
	Individual	**Collective**	**Individual**	**Collective**	**Total**
2016					
At the beginning of the year	**3.1**	**102.3**	**116.0**	**7.3**	**228.7**
Transfer into Company	**-**	**3.1**	**-**	**17.3**	**20.4**
Reclassification between collective & individual	**(2.1)**	**2.1**	**-**	**-**	**-**
(Release)/charge against profits	**-**	**1.9**	**23.0**	**(6.4)**	**18.5**
Amounts written off	**(0.5)**	**(44.4)**	**(91.6)**	**(1.6)**	**(138.1)**
Unwind of discount allowance	**-**	**-**	**(1.2)**	**-**	**(1.2)**
At the end of the year	**0.5**	**65.0**	**46.2**	**16.6**	**128.3**

	Core		Non-core		
	Individual	Collective	Individual	Collective	Total
2015					
At the beginning of the year	3.2	109.1	221.4	11.6	345.3
(Release)/charge against profits	(1.4)	4.2	12.7	(6.4)	9.1
Amounts written off	1.3	(8.8)	(116.7)	2.1	(122.1)
Unwind of discount allowance	-	(2.2)	(1.4)	-	(3.6)
At the end of the year	3.1	102.3	116.0	7.3	228.7

A reclassification of retail secured provisions from 'individual' to 'collective' has been made in the year, to better reflect the nature of the provisioning calculation.

Core provisions are analysed in further detail below:

	Core				
	Retail		**BaCB**		
	Individual	**Collective**	**Individual**	**Collective**	**Total core**
2016					
At the beginning of the year	**2.1**	**101.5**	**1.0**	**0.8**	**105.4**
Transfer into Company	**-**	**3.1**	**-**	**-**	**3.1**
Reclassification between collective & individual	**(2.1)**	**2.1**	**-**	**-**	**-**
(Release)/charge against profits	**-**	**2.2**	**-**	**(0.3)**	**1.9**
Amounts written off	**-**	**(44.4)**	**(0.5)**	**-**	**(44.9)**
At the end of the year	**-**	**64.5**	**0.5**	**0.5**	**65.5**

	Core				
	Retail		BaCB		
	Individual	Collective	Individual	Collective	Total core
2015					
At the beginning of the year	1.8	106.9	1.4	2.2	112.3
(Release)/charge against profits	(1.5)	5.6	0.1	(1.4)	2.8
Amounts written off	1.8	(8.8)	(0.5)	-	(7.5)
Unwind of discount allowance	-	(2.2)	-	-	(2.2)
At the end of the year	2.1	101.5	1.0	0.8	105.4

Loans and advances to customers include finance lease receivables:

	2016	2015
Gross investment in finance leases may be analysed as follows:		
No later than one year	**2.2**	1.9
Later than one year and no later than five years	**7.0**	7.2
Later than five years	**13.3**	14.9
	22.5	24.0
Unearned future finance income on finance leases	**(7.3)**	(8.2)
Net investment in finance leases	**15.2**	15.8

The net investment in finance leases may be analysed as follows:		
No later than one year	**1.4**	1.0
Later than one year and no later than five years	**4.2**	4.1
Later than five years	**9.6**	10.7
	15.2	15.8

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 fair value changes in its portfolio of fixed rate mortgages due to interest rate movements. Changes in the fair values of these swaps are offset by a change in the fair value of the mortgages due to interest rate movements.

	2016	2015
Gross fair value adjustments for hedged risk	**131.6**	98.0
Less: impairment provision	**-**	(4.0)
	131.6	94.0

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

	2016	2015
At the beginning of the year	**4.0**	48.3
Release for the year	**(4.0)**	(44.3)
At the end of the year	**-**	4.0

7. Investment securities

a) Loans and receivables

	2016	2015
Loans and receivables:		
Listed	**34.8**	66.1
Unlisted	**-**	-
Total gross investment securities - loans and receivables	**34.8**	66.1
Less: allowance for losses	**-**	-
Total net investment securities - loans and receivables	**34.8**	66.1

Movement in investment securities - loans and receivables

	2016	2015
At the beginning of the year	**66.1**	73.5
Disposals and maturities	**(38.3)**	(9.7)
Exchange adjustments	**2.7**	(2.4)
Amortisation	**4.3**	3.2
Movement in interest accrual	**-**	1.5
At the end of the year	**34.8**	66.1

b) Available for sale

	2016	2015
Available for sale:		
Listed	**3,538.1**	4,296.8
Unlisted	**-**	-
Total gross investment securities available for sale	**3,538.1**	4,296.8
Less: allowance for losses	**-**	-
Total net investment securities available for sale	**3,538.1**	4,296.8

Movement in investment securities - available for sale

	2016	2015
At the beginning of the year	**4,296.8**	2,828.6
Acquisitions	**363.7**	1,916.3
Disposals and maturities	**(1,161.5)**	(404.9)
Fair value movements through equity	**12.7**	(19.0)
Fair value through profit or loss	**32.2**	(17.7)
Amortisation	**(1.5)**	(6.6)
Movement in interest accrual	**(4.3)**	0.1
At the end of the year	**3,538.1**	4,296.8

c) Fair value through profit or loss

	2016	2015
Fair value listed through profit or loss (FVTPL):		
Listed	**-**	582.4
Unlisted	**-**	-
Total gross investment securities (FVTPL)	**-**	582.4
Less: allowance for losses	**-**	-
Total net investment securities (FVTPL)	**-**	582.4

Movement in investment securities - fair value through profit or loss

	2016	2015
At the beginning of the year	**582.4**	1,236.9
Disposals and maturities	**(566.5)**	(639.9)
Fair value through profit or loss	**(13.1)**	(10.7)
Movement in interest accrual	**(2.8)**	(3.9)
At the end of the year	**-**	582.4

d) Analysis of investment securities by issuer

	2016	2015
Investment securities issued by public bodies:		
Government securities	**1,661.5**	2,518.0
Other public sector securities	**173.7**	87.2
Total investment securities issued by public bodies	**1,835.2**	2,605.2
Other debt securities:		
Other floating rate notes	**395.5**	674.2
Mortgage backed securities	**1,342.2**	1,665.9
Total investment securities issued by other issuers	**1,737.7**	2,340.1
Total investment securities	**3,572.9**	4,945.3

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

8. Derivative financial instruments

The Company has entered, as principal, into various derivatives either as economic hedges which are treated as held for trading (not in a qualifying hedge relationship), or in a qualifying hedge accounting relationship for the management of interest rate risk and foreign exchange rate risk. Positive and negative fair values have not been netted off as the Company does not have a legal right of offset.

Non-trading derivatives

Non-trading transactions comprise derivatives held for hedging purposes to manage the asset and liability positions of the Company and 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 Company has entered into fair value hedges to mitigate price movements due to interest rate sensitivities.

	2016		2015	
	Fair value		Fair Value	
	Assets	**Liabilities**	Assets	Liabilities
Derivatives held for non-trading purposes				
Derivatives designated as cash flow hedges:				
Interest rate swaps	**72.1**	**(3.6)**	35.1	(9.2)
Derivatives designated as fair value hedges:				
Interest rate swaps	**23.4**	**(246.3)**	10.8	(189.6)
Cross currency interest rate swaps	**-**	**-**	-	-
Derivatives held for non-trading purposes for which hedge accounting has not been applied:				
Interest rate swaps	**162.4**	**(182.9)**	124.2	(138.6)
Cross currency interest rate swaps	**-**	**(0.5)**	2.2	(0.3)
Forward currency transactions	**0.4**	**(0.6)**	2.1	(4.0)
OTC interest rate options	**0.3**	**(0.3)**	0.2	(0.2)
Equity swaps	**2.6**	**-**	18.6	-
Credit default swaps with subsidiary undertakings	**-**	**(61.6)**	-	(61.3)
Total derivative assets/(liabilities) held for non-trading purposes	**261.2**	**(495.8)**	193.2	(403.2)
Total recognised derivative assets/(liabilities)	**261.2**	**(495.8)**	193.2	(403.2)

9. Equity shares

	2016	2015
Investment securities:		
Listed	**0.2**	0.1
Unlisted	**44.6**	53.6
	44.8	53.7
Included above are the following trade investments:		
Visa International - (38,847 Series B Preference Shares) (2015: 0)	**19.3**	-
Visa Europe - 1 ordinary share of €10	**-**	51.2
VocaLink Holdings Limited - 4,416,165 ordinary shares of £1 each (2015: 4,416,165)	**25.3**	2.4

Equity shares are classified as available for sale. The fair value of Visa International has been remeasured based on the equity price of Visa International shares, discounted for the estimated amount of preference shares to be clawed back and an illiquidity discount. See note 38 of the Bank financial statements for the valuation techniques used to calculate the fair value of equity shares. The fair value of Vocalink Holdings Limited has been remeasured with reference to the offer that the Bank and other Vocalink shareholders have received from MasterCard to acquire a majority shareholding.

10. Intangible assets

	2016			2015		
	Internally generated intangible assets	**Other intangible assets**	**Total**	Internally generated intangible assets	Other Intangible assets	Total
Cost						
At the beginning of the year	**241.9**	**46.0**	**287.9**	471.2	46.0	517.2
Additions	**26.5**	**-**	**26.5**	73.2	-	73.2
Disposals	**(65.0)**	**(4.2)**	**(69.2)**	(2.4)	-	(2.4)
Impairment	**(40.6)**	**-**	**(40.6)**	(0.3)	-	(0.3)
Write off of fully amortised assets	**-**	**-**	**-**	(296.1)	-	(296.1)
Transfer to property, plant and equipment	**-**	**-**	**-**	(3.7)	-	(3.7)
At the end of the year	**162.8**	**41.8**	**204.6**	241.9	46.0	287.9
Accumulated amortisation and impairment						
At the beginning of the year	**114.1**	**31.0**	**145.1**	387.3	26.5	413.8
Charge for the year	**24.9**	**4.2**	**29.1**	25.0	4.5	29.5
Disposals	**(65.5)**	**(4.2)**	**(69.7)**	(2.1)	-	(2.1)
Write off of fully amortised assets	**-**	**-**	**-**	(296.1)	-	(296.1)
At the end of the year	**73.5**	**31.0**	**104.5**	114.1	31.0	145.1
Net book value						
At the end of the year	**89.3**	**10.8**	**100.1**	127.8	15.0	142.8
At the beginning of the year	**127.8**	**15.0**	**142.8**	83.9	19.5	103.4

Internally generated intangible assets of £32.5m associated with the transformation of the outsourced mortgage processing services have been written off as detailed in note 9 to the Bank financial statements. Internally generated assets include £17.1m (2015: £67.5m) of assets in the course of construction.

Other intangible assets consist of a core deposit intangible of £10.8m (2015: £15.0m).

11. Investment properties

	2016	2015
Fair value		
At the beginning of the year	**2.1**	2.1
Disposals	**(0.1)**	(0.1)
Changes in fair value	**0.2**	0.1
At the end of the year	**2.2**	2.1

At the year end, investment properties relate solely to the Company'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 level 3 of the fair value hierarchy (see note 27). 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.

All investment properties are held to generate rental income until such time that the Company considers it appropriate to realise its investment.

12. Property, plant and equipment

2016	Land and buildings	Leasehold improvements	Computers and other equipment	Assets in the course of construction	Total
Cost					
At the beginning of the year	**23.2**	**23.7**	**100.6**	**2.3**	**149.8**
Additions	**2.7**	**-**	**3.1**	**8.0**	**13.8**
Disposals	**(5.2)**	**(23.7)**	**(68.1)**	**-**	**(97.0)**
Classified as held for sale	**(6.2)**	**-**	**-**	**-**	**(6.2)**
Impairment	**-**	**-**	**-**	**(1.0)**	**(1.0)**
At the end of the year	**14.5**	**-**	**35.6**	**9.3**	**59.4**
Accumulated depreciation					
At the beginning of the year	**4.7**	**23.6**	**79.3**	**-**	**107.6**
Charge for the year	**4.1**	**-**	**7.7**	**-**	**11.8**
Disposals	**(2.7)**	**(23.6)**	**(63.5)**	**-**	**(89.8)**
Classified as held for sale	**(2.0)**	**-**	**-**	**-**	**(2.0)**
At the end of the year	**4.1**	**-**	**23.5**	**-**	**27.6**
Net book value					
At the end of the year	**10.4**	**-**	**12.1**	**9.3**	**31.8**
At the beginning of the year	**18.5**	**0.1**	**21.3**	**2.3**	**42.2**

2015	Land and buildings	Leasehold improvements	Computers and other equipment	Assets in the course of construction	Total
Cost					
At the beginning of the year	32.1	25.1	142.1	1.0	200.3
Additions	-	-	4.0	2.5	6.5
Disposals	(4.7)	(1.4)	(50.4)	-	(56.5)
Transfer from intangibles	-	-	4.9	(1.2)	3.7
Classified as held for sale	(4.2)	-	-	-	(4.2)
At the end of the year	23.2	23.7	100.6	2.3	149.8
Accumulated depreciation					
At the beginning of the year	5.2	24.4	107.6	-	137.2
Charge for the year	0.8	0.6	8.3	-	9.7
Disposals	(0.5)	(1.4)	(36.6)	-	(38.5)
Classified as held for sale	(0.8)	-	-	-	(0.8)
At the end of the year	4.7	23.6	79.3	-	107.6
Net book value					
At the end of the year	18.5	0.1	21.3	2.3	42.2
At the beginning of the year	26.9	0.7	34.5	1.0	63.1

13. Other assets

	2016	Re-presented 2015
Amounts recoverable within one year:		
Other assets	**80.7**	111.6
Amounts owed by The Co-operative Group	**10.2**	37.5
Deferred consideration receivable	**0.3**	-
Amounts recoverable after more than one year:		
Amounts owed by The Co-operative Group	**53.7**	43.7
Deferred consideration receivable	**4.0**	-
	148.9	192.8

The 2015 re-presentation moves balances to Other assets from Trade debtors to better reflect the nature of the balances.

Amounts owed by The Co-operative Group include group tax relief recoverable of £60.9m (2015: £47.3m). Further details of the related party relationship of the Company with The Co-operative Group and its undertakings are contained in note 25.

14. Prepayments and accrued income

	2016	2015
Amounts recoverable within one year	**24.1**	35.4
Amounts recoverable after more than one year	**4.6**	8.1
	28.7	43.5

Prepayments totalling £16.0m have been impaired by the Company during the year. This impairment is associated with the cessation of the activity to transform the mortgage outsource service and the subsequent write off of an asset which is no longer expected to provide future economic benefit.

15. Deposits by banks

	2016	2015
Items in course of collection	**20.5**	31.8
Deposits from other banks	**1,178.1**	684.1
	1,198.6	715.9

Included within deposits from other banks are liabilities of £1,169.3m (2015: £671.2m) secured on investment securities with a carrying value of £1,260.1m (2015: £721.7m) which have been sold under sale and repurchase agreements (note 27).

16. Customer accounts - capital bonds

	2016	2015
Retail	**11.8**	77.4

The capital bonds are fixed term customer accounts with returns based on the movement in an index (e.g. 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 Company would contractually be required to pay at maturity for all the capital bonds is £11.8m (2015: £77.4m).

The Company 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 £15.7m (2015: £20.9m). However, taking into account changes in fair value of the associated swaps, the net impact to the income statement for the year is £0.4m (2015: £nil).

17. Debt securities in issue

	2016	2015
Fixed and floating rate notes	**1,006.8**	1,005.7

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. Where appropriate, the Company applies fair value hedge accounting to reduce the accounting volatility from these positions.

Debt securities in issue include fixed and floating rate notes, the majority of which are secured on portfolios of variable and fixed rate mortgages. Some of these notes (securitisations) are redeemable in part from time to time, with such redemptions being limited to the net capital received from mortgagors in respect of the underlying assets. There is no obligation for the Company to make good any shortfall out of general funds. Other notes (covered bonds secured and certificates of deposit) require the Company to repay contractual amounts due on specified maturity dates.

18. Other borrowed funds

	2016	2015
Fixed rate subordinated notes 2025	**250.0**	250.0
Fixed rate subordinated notes 2023	**206.0**	206.0
Issue costs, discounts and accrued interest	**2.4**	1.0
Fair value hedge accounting adjustment	**14.2**	2.9
	472.6	459.9

The 2025 subordinated notes were issued on 1 July 2015 and have a call date on 1 July 2020. These notes carry an annual interest rate of 8.5% to maturity and Interest is payable annually in arrears. The 2023 subordinated notes were issued on 20 December 2013 and mature on 20 December 2023. These notes carry an annual interest rate of 11% to maturity and Interest is payable quarterly in arrears.

The notes have been admitted to trading on the London Stock Exchange; they are Tier 2 capital and an unsecured obligation of the Company.

19. Other liabilities

	2016	Re-presented 2015
Amounts falling due within one year:		
ATM creditor	**4.6**	1.2
Other creditors	**31.4**	35.6
Amounts falling due after one year:		
Other creditors	**8.9**	8.0
	44.9	44.8

The above table has been re-presented to provide more granularity and better reflect the nature of the balances.

Other creditors of the Company include finance lease obligations as follows:

	Present value of lease payments		**Future minimum lease payments**	
	2016	2015	**2016**	2015
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**	1.2	**1.5**	1.6
	1.4	1.3	**1.6**	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.

20. Accruals and deferred income

	2016	2015
Amounts falling due within one year	**80.3**	126.2
Amounts falling due after one year	**11.0**	-
	91.3	126.2

21. Provisions for liabilities and charges

2016	Property	FSCS levies	PPI	Conduct/ legal	Separation	Other	Total
At the beginning of the year	**42.7**	**10.8**	**87.0**	**229.3**	**64.3**	**24.4**	**458.5**
Provided/(released) in the year:							
Interest income	**-**	**-**	**-**	**2.3**	**-**	**-**	**2.3**
Operating expense	**1.0**	**4.9**	**-**	**(1.0)**	**16.2**	**37.5**	**58.6**
Provision for customer redress	**-**	**-**	**36.0**	**(11.3)**	**-**	**-**	**24.7**
Utilised during the year	**(11.7)**	**(9.1)**	**(32.6)**	**(173.9)**	**(53.2)**	**(23.1)**	**(303.6)**
Transferred from Group undertakings	**-**	**-**	**-**	**33.7**	**-**	**1.3**	**35.0**
At the end of the year	**32.0**	**6.6**	**90.4**	**79.1**	**27.3**	**40.1**	**275.5**

Provisions were analysed as follows:							
Amounts falling due within one year	**15.4**	**6.6**	**34.1**	**71.5**	**27.3**	**30.9**	**185.8**
Amounts falling due after one year	**16.6**	**-**	**56.3**	**7.6**	**-**	**9.2**	**89.7**
Total provisions	**32.0**	**6.6**	**90.4**	**79.1**	**27.3**	**40.1**	**275.5**

2015	Property	FSCS levies	PPI	Conduct/ legal	Separation	Other	Total
At the beginning of the year	23.4	12.6	73.6	299.0	112.3	25.4	546.3
Transferred from CFSMS	23.8	-	-	-	-	6.6	30.4
Provided/(released) in the year:							
Interest income	-	-	-	58.3	-	-	58.3
Operating expense	3.4	18.9	-	-	8.9	14.5	45.7
Provision for customer redress	-	-	71.8	68.7	-	(0.9)	139.6
Utilised during the year	(7.9)	(20.7)	(58.4)	(196.7)	(56.9)	(21.2)	(361.8)
At the end of the year	42.7	10.8	87.0	229.3	64.3	24.4	458.5

Provisions were analysed as follows:							
Amounts falling due within one year	25.9	10.8	40.7	206.7	64.3	22.7	371.1
Amounts falling due after one year	16.8	-	46.3	22.6	-	1.7	87.4
Total provisions	42.7	10.8	87.0	229.3	64.3	24.4	458.5

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 Company has incurred dilapidations and/or the dilapidation clause within the contract has been invoked.

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 Company, 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 £36.0m was recognised in the year (2015: £71.8m), in respect of the total expected cost to the Bank of carrying out this work and paying compensation. The provision increase reflects the Bank's year end estimates of the impact of both the FCA Consultation Paper CP16/20 and the FCA's publication of PS17/3 on 2 March 2017 which specifies that the time bar will end on 29 August 2019.
As a result, the total provision raised by the Bank to date is £459.8m.

Conduct/legal provisions

During the period the Company provided £2.3m (2015: £58.3m) in respect of interest income in relation to breaches of the technical requirements of the CCA.

The Company released net £11.3m (31 December 2015: £68.7m net charge) of provision for customer redress. This includes a £12.5m release on breaches of the technical requirements of the CCA, following amendments to the underlying redress assumptions as the remediation programme nears completion. There was a further release of £15.3m on other projects including Interest Rate Hedging and Affinion, £20.1m charge on the Mortgage Rectification Programme relating to historic calculations of the Monthly Mortgage Payments, and a net release of £3.6m on other Mortgage issues following the maturity of projects and agreed redress approach with the FCA.

Other

In February 2017, the Company agreed a variation to the contract with its outsourced mortgage provider, to reduce the duration of the contract and to amend the costs of outsourced mortgage service provision for the period to 31 December 2016. Accordingly a provision of £21.7m is included in the Company Financial Statements as at 31 December 2016.

22. Deferred tax

Deferred taxes are calculated on all temporary differences under the liability method using the most appropriate tax rate in respect of each temporary difference.

The UK corporation tax will reduce from 20% to 19% (effective from 1 April 2017) and then to 17% (effective from 1 April 2020); the latter rate change was enacted on 15 September 2016. A banking surcharge tax of 8% also applies to the Bank (effective from 1 January 2016). Deferred tax has been calculated by reference to the most appropriate rate based on forecasts.

The movements on the deferred tax asset accounts are as follows:

	2016	2015
Deferred tax at the beginning of the year	**2.0**	2.5
Credited/(charged) to the income statement:		
Current year	**10.3**	5.3
Prior year	**-**	1.8
Impact of corporation tax rate charge	**(2.1)**	4.9
	8.2	12.0
Credited/(charged) to other comprehensive income:		
Available for sale	**2.5**	(12.5)
Cash flow hedges	**(7.3)**	-
Pension reserve	**(3.8)**	-
	(8.6)	(12.5)
Deferred tax at the end of the year	**1.6**	2.0
Components of net deferred tax:		
Deferred tax assets	**38.7**	26.3
Deferred tax liability	**(37.1)**	(24.3)
	1.6	2.0

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 £1.6m (2015: £2.0m).

	2016	2015
Deferred tax comprises:		
Capital allowances on fixed assets and assets leased to customers	**38.7**	22.3
Cash flow hedges	**(17.4)**	(11.2)
Unrealised appreciation on investments	**(11.8)**	(13.1)
Pensions and post-retirement benefits	**(5.1)**	-
Other temporary differences	**(2.8)**	-
Capital losses	**-**	4.0
	1.6	2.0

The deferred tax credit in the income statement comprises:

	2016	2015
Capital allowances on fixed assets and assets leased to customers	**(16.4)**	(7.7)
Cash flow hedges	**(1.1)**	(0.3)
Unrealised appreciation on investments	**4.0**	-
Pensions and post-retirement benefits	**1.3**	-
Capital losses	**4.0**	(4.0)
	(8.2)	(12.0)

Deferred tax assets totalling £409.0m (2015: £352.9m) 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 £1,952.0m (with deferred tax of £351.6m) and other temporary differences of £229.4m (with deferred tax of £57.4m). Deferred tax assets of £47.5m (2015: £77.8m) in respect of the current year have not been recognised.

New legislation was enacted in 2016 with the effect that from 1 April 2016, only 25% of a bank's taxable profits can be relieved by brought forward losses. The Government announced on 16 March 2016 that further changes to the rules on the utilisation of tax losses will be introduced effective from 1 April 2017; however the new legislation has not yet been enacted.

23. Contingent liabilities

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 CRD IV rules.

The contingent liabilities, as detailed below, arise in the normal course of banking business and it is not practical to quantify their future financial effect.

		Unaudited		Unaudited
	Contract amount 2016	**Risk weighted amount 2016**	Contracted amount 2015	Risk weighted amount 2015
Contingent liabilities:				
Guarantees and irrevocable letters of credit	**12.1**	**4.6**	21.0	15.0
Other commitments:				
Undrawn formal standby facilities, credit lines and other commitments to lend (includes revocable and irrevocable commitments)[1]	**2,277.4**	**296.2**	2,108.0	281.4
	2,289.5	**300.8**	2,129.0	296.4

1. Undrawn loan commitments include revocable commitments which are unused credit card limits of £1,376.2m (2015: £1,557.6m).

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 requirement.

See note 27 for further details of assets pledged.

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 table below discloses the minimum operating lease payments the Company will be required to make over the remaining lives of the leases.

Falling due:	**Land and buildings 2016**	Land and buildings 2015
Within one year	**12.2**	14.0
Between one and five years	**33.7**	30.2
In five years or more	**73.6**	84.3
	119.5	128.5

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 £4.2m (2015: £13.9m).

Commitments to financially support subsidiary undertakings

Where relevant, the Company has committed to financially support certain subsidiary undertakings.

24. Investments in subsidiaries/group undertakings

	2016			2015		
	Ordinary shares	**Capital contributions**	**Total**	Ordinary shares	Capital contributions	Total
At the beginning of the year	**565.9**	**648.5**	**1,214.4**	544.5	517.0	1,061.5
Additions	**148.5**	**303.1**	**451.6**	-	131.5	131.5
Repayments	**-**	**(320.3)**	**(320.3)**	-	-	-
Reclassification	**-**	**-**	**-**	11.4	-	11.4
Impairment (write back)	**-**	**-**	**-**	11.6	-	11.6
Impairment (write down)	**(538.9)**	**-**	**(538.9)**	(1.6)	-	(1.6)
At the end of the year	**175.5**	**631.3**	**806.8**	565.9	648.5	1,214.4

Subsidiary undertakings

Subsidiary undertakings which are registered in England and operating in the UK:

	Footnote		**Shareholding 2016**	Shareholding 2015
Co-operative Commercial Limited	1	Investment company	**100%**	100%
Roodhill Leasing Limited	1	Leasing	**100%**	100%
First Roodhill Leasing Limited	1	Leasing	**100%**	100%
Second Roodhill Leasing Limited	1	Leasing	**100%**	100%
Third Roodhill Leasing Limited	1	Leasing	**100%**	100%
Fourth Roodhill Leasing Limited	1	Leasing	**100%**	100%
Britannia Treasury Services Limited	2	Holding company	**100%**	100%
Britannia Asset Management Limited	3	Earning interest on intercompany balances	**100%**	100%
Britannia Estate Agents Limited	2	Former letting agent	**100%**	100%
Britannia Pension Trustees Limited	2	Pension scheme participant	**100%**	100%
BPS Principal Employer Limited	2	Holding company	**100%**	100%
Britannia Development and Management Company Limited	2	Property investment	**100%**	100%
Moorland Covered Bonds LLP	2	Mortgage acquisition and guarantor of covered bonds	**100%**	100%
Second Pioneers Leasing Limited	1	Leasing	**100%**	100%
CIS Mortgage Maker Limited	2	Inactive	**100%**	100%
Co-operative Bank Financial Advisers Limited	1	Inactive	**100%**	100%

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.

	Footnote	
Mortgage Agency Services Number One Limited	2	Mortgage and syndicated lending
Mortgage Agency Services Number Two Limited	2	Mortgage lending
Mortgage Agency Services Number Four Limited	2	Mortgage lending
Mortgage Agency Services Number Five Limited	2	Mortgage lending
Mortgage Agency Services Number Six Limited	2	Mortgage lending
Platform Group Holdings Limited	4	Holding Company

Platform Group Holdings Limited has the following subsidiary undertakings, registered in England, operating in the UK and trading in the businesses indicated:

Direct subsidiaries:	Footnote	
Platform Consumer Services Limited	4	Holding Company
Indirect subsidiaries:		
Platform Funding Limited	2	Mortgage lending
Platform Home Loans Limited	2	Mortgage origination and related services

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

Britannia International Limited Company surrendered its Class 1 Deposit-Taking Licence to the Isle of Man Financial Supervision Commission during 2015. Any remaining customer accounts were closed and placed into a scheme to manage these funds.

Registered in Scotland and operating in the UK:

	Footnote	
Britannia Life Direct Limited	3	Earning interest on intercompany balances

Securitisation vehicles
The results of the following securitisation vehicles are consolidated into the results of the Bank:

	Footnote	
Leek Finance Number Seventeen plc	5	Securitisation company
Leek Finance Number Eighteen plc	5	Securitisation company
Leek Finance Number Nineteen plc	5	Securitisation company
Meerbrook Finance Number Four Limited	6	Securitisation company
Meerbrook Finance Number Eight Limited	6	Securitisation company
Silk Road Finance Number Three plc	6	Securitisation company
Calico Finance Number One Limited	7	Securitisation company

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. The following securitisation vehicles were dissolved by the Company during 2016:

		Date of dissolution
Leek Finance Number Seventeen plc	Securitisation company	21 June 2016
Leek Finance Number Eighteen plc	Securitisation company	21 December 2016
Meerbrook Finance Number Eight Limited	Securitisation company	22 August 2016
Silk Road Finance Number Three plc	Securitisation company	21 September 2016

See note 38 to the Bank financial statements for further details of securitisation vehicles.

Joint Ventures
The Company has investments in the following joint ventures:

	Ownership 2016	Ownership 2015
Britannia Personal Lending Limited	**49%**	49%
Britannia New Homes (Scotland) Limited (Dormant)	**50%**	50%

Britannia Personal Lending Limited has its registered office at Trinity Road, Halifax, HX1 2RG.

Britannia New Homes (Scotland) Limited has its registered office at 140 West George Street, Glasgow, G2 2HG.

See note 35 to the Bank financial statements for further details of joint ventures.

Dormant Companies

The Company has investments in the following dormant subsidiaries all of which are registered in England, with the exception of Britannia LAS Direct Limited which is registered in Scotland:

	Footnote
Britannia (Isle of Man) Limited	4
Britannia LAS Direct Limited	3
Cambrian Care Limited	4
Cleveland Finance Limited	2
Cleveland Guaranty Limited	2
Co-operative Bank (Insurance Services) Limited[4]	4
Day & Son (Builders) Limited	2
First Co-operative Finance Limited	4
Haydn Evans Construction (South Wales) Limited	2
Larchvale Limited	4
PCSL Services No 1 Limited	4
Phoenix Credit Services Limited	4
Second Pioneers Leasing Limited	4
The Co-operative Bank Pension Trust Limited	1
Verso Limited	4

Footnote	Registered office at:
1	PO Box 101, 1 Balloon Street, Manchester, M60 4EP
2	Secretariat, Miller Street Tower, Miller Street, Manchester, M60 0AL
3	3-5 Melville Street, Edinburgh, EH3 7PE, Scotland
4	Hill House 1, Little New Street, London, EC4A 3TR
5	4th Floor, 40 Dukes Place, London, EC3A 7NH
6	35 Great St Helens, London, EC3A 6AP
7	Fourth Floor, 3 George's Dock, IFSC, Dublin 1, Ireland

25. Related party transactions

Parent, subsidiary and ultimate controlling party

The Company has three significant shareholders; The Co-operative Banking Group Limited, a subsidiary of The Co-operative Group, holding over 20% of the Bank's shares and SP COOP Investments Limited and Golden Tree Asset Management funds each holding over 10% of the Bank's shares.

The Shareholder Rights Agreement grants certain rights to shareholders including the right of Silverpoint Capital and Perry Capital to nominate a Director for appointment to the Board for so long as it continues to own 5% or more of the Bank.

At 31 December 2016, the Bank is an associate of, and therefore a related party of, The Co-operative Group and its subsidiaries. As The Co-operative Group is a significant shareholder, it has the right to Bank Board representation and there are material transactions between the two companies.

Transactions with The Co-operative Group

The Company continues to progress with separation from The Co-operative Group and remains subject to legal agreements entered into and indemnities provided prior to separation. The Bank has also entered into new agreements with The Co-operative Group in relation to IT, the provision of tax losses and estates, as part of separation.

The Chair of the Bank's Audit Committee and Non-Executive Director Glyn Smith is also a Non-Executive Director of a not-for-profit subsidiary of The Co-operative Group, Reclaim Fund Limited (RFL), from which The Co-operative Group derives no financial benefit.

Further details of the transactions with The Co-operative Group and its subsidiary undertakings are disclosed in note 36 to the Bank financial statements.

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 2016 Company Financial Statements, which include a group relief debtor of £60.9m (2015: £47.3m), 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. These amounts are included within Other Assets.

Further details of the transactions with The Co-operative Group are disclosed in note 36 to the Bank financial statements.

Balances with other Co-operative Bank undertakings

The following tables show the value of transactions with The Co-operative Bank plc undertakings during the year.

Amounts owed by Co-operative Bank undertakings	**2016**	Restated 2015
Amounts owed by Co-operative Bank subsidiaries (excluding special purpose entities)	**898.8**	7,183.9
Amounts owed by Co-operative Bank subsidiaries - special purpose entities	**207.5**	1,138.9
	1,106.3	8,322.8
Cash balances deposited with the Company by Co-operative Bank subsidiaries (excluding special purpose entities)	**(133.3)**	(132.6)
	973.0	8,190.2

Amounts owed to Co-operative Bank undertakings	**2016**	Re-presented 2015
Amounts owed to Co-operative Bank subsidiaries (excluding special purpose entities)	**1,538.5**	1,956.0
Amounts owed to Co-operative Bank subsidiaries - special purpose entities	**602.5**	1,230.4
	2,141.0	3,186.4
Derivative liabilities to Co-operative Bank subsidiaries (excluding special purpose entities)	**46.5**	48.2
Derivative liabilities to Co-operative Bank subsidiaries - special purpose entities	**15.0**	12.3
	2,202.5	3,246.9

The 2015 balances have been restated as set out in Note 1 to the Company financial statements and re-presented to further analyse derivative balances with subsidiary undertakings and special purpose entities (SPEs).

In addition to the above balances with SPEs, the Company holds floating rate notes in Leek Finance Number Nineteen plc of £17.9m (2015: £22.8m) included within investment securities - available for sale.

During the year the Company purchased £7.2bn of mortgage assets from its subsidiaries as part of business transfer agreements, where the majority of operations, assets and liabilities of Platform Funding Limited, Mortgage Agency Services Number One Limited, Mortgage Agency Services Number Two Limited, Mortgage Agency Services Number Four Limited, Mortgage Services Number Five Limited and Mortgage Services Number Six Limited were transferred to the Company.

For the transfer of business, the Company paid consideration equivalent to the carrying value of the assets and liabilities. Carrying value was determined with reference to the carrying value of assets and liabilities at the Bank consolidated level.

The loans owed to the SPEs comprise cash balances deposited with the Company. There are no formal repayment terms with subsidiary companies.

Balances with other The Co-operative Group undertakings

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

	2016			
	Loans & advances to customers	**Other assets**	**Customer accounts**	**Other liabilities**
The Co-operative Group Limited and its subsidiaries	**-**	**61.2**	**(116.6)**	**-**
The Co-operative Banking Group Limited and its subsidiaries	**-**	**2.7**	**(1.7)**	**-**
	-	**63.9**	**(118.3)**	**-**

	2015			
	Loans & advances to customers	Other assets	Customer accounts	Other liabilities
The Co-operative Group Limited and its subsidiaries	1.0	45.2	(100.1)	-
The Co-operative Banking Group Limited and its subsidiaries	-	19.2	(4.9)	(6.1)
	1.0	64.4	(105.0)	(6.1)

The following tables show the value of transactions with The Co-operative Bank plc undertakings during the year.

2016	**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)	**83.1**	**39.4**	**1.1**	**0.9**	**1.9**
Transactions with Co-operative Bank subsidiaries - special purpose entities	**27.3**	**42.5**	**-**	**-**	**-**

Re-presented 2015	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)	80.7	25.6	6.3	1.3	3.8
Transactions with Co-operative Bank subsidiaries - special purpose entities	48.2	15.4	-	-	-

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 36 to the Bank financial statements.

26. Share capital

	2016		2015	
	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	**451.5**	**22.6**	451.5	22.6
At the end of the year	**451.5**	**22.6**	451.5	22.6

Share premium account		
At the beginning of the year	**1,736.9**	1,736.9
At the end of the year	**1,736.9**	1,736.9

The number of ordinary shares in issue at 31 December 2016 was 451,456,510 (2015: 451,456,510). The ordinary shareholders have one vote for every share held.

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. 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
2016							
Assets							
Cash and balances at central banks	-	-	2,848.2	-	-	-	2,848.2
Loans and advances to banks	-	-	619.1	-	-	-	619.1
Loans and advances to customers	4.1	188.9	19,100.4	-	-	-	19,293.4
Fair value adjustments for hedged risk	-	-	131.6	-	-	-	131.6
Investment securities	-	-	34.8	3,538.1	-	-	3,572.9
Derivative financial instruments	165.7	-	-	-	-	95.5	261.2
Equity shares	-	-	-	44.8	-	-	44.8
Amounts owed by other Co-operative Bank undertakings	-	-	1,106.3	-	-	-	1,106.3
Other assets	-	-	148.9	-	-	-	148.9
Total financial assets	**169.8**	**188.9**	**23,989.3**	**3,582.9**	**-**	**95.5**	**28,026.4**
Non-financial assets							**996.8**
Total assets							**29,023.2**
Liabilities							
Deposits by banks	-	-	-	-	1,198.6	-	1,198.6
Customer accounts	-	-	-	-	22,558.5	-	22,558.5
Customer accounts – capital bonds	-	11.8	-	-	-	-	11.8
Debt securities in issue	-	-	-	-	1,006.8	-	1,006.8
Derivative financial instruments	245.9	-	-	-	-	249.9	495.8
Other borrowed funds	-	-	-	-	472.6	-	472.6
Amounts owed to other Co-operative Bank undertakings	-	-	-	-	2,141.0	-	2,141.0
Other liabilities	-	-	-	-	44.9	-	44.9
Total financial liabilities	**245.9**	**11.8**	**-**	**-**	**27,422.4**	**249.9**	**27,930.0**
Non-financial liabilities							**366.8**
Total liabilities							**28,296.8**
Capital and reserves							**726.4**
Total liabilities and equity							**29,023.2**

Whilst the Company does not hold any derivative financial instruments that are considered ‘derivatives held for trading purposes’, IAS 39 requires derivative financial instruments that are not in a hedging relationship to be classified as ‘held for trading’.

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

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
Restated 2015							
Assets							
Cash and balances at central banks	-	-	2,670.1	-	-	-	2,670.1
Loans and advances to banks	-	-	452.1	-	-	-	452.1
Loans and advances to customers	4.2	174.0	12,302.9	-	-	-	12,481.1
Fair value adjustments for hedged risk	-	-	94.0	-	-	-	94.0
Investment securities	-	582.4	66.1	4,296.8	-	-	4,945.3
Derivative financial instruments	147.3	-	-	-	-	45.9	193.2
Amounts owed by other Co-operative Bank undertakings	-	-	8,322.8	-	-	-	8,322.8
Equity shares	-	-	-	53.7	-	-	53.7
Other assets	-	-	192.8	-	-	-	192.8
Total financial assets	151.5	756.4	24,100.8	4,350.5	–	45.9	29,405.1
Non-financial assets							1,450.4
Total assets							30,855.5
Liabilities							
Deposits by banks	-	-	-	-	715.9	-	715.9
Customer accounts	-	-	-	-	23,135.3	-	23,135.3
Customer accounts – capital bonds	-	77.4	-	-	-	-	77.4
Debt securities in issue	-	-	-	-	1,005.7	-	1,005.7
Derivative financial instruments	204.4	-	-	-	-	198.8	403.2
Other borrowed funds	-	-	-	-	459.9	-	459.9
Amounts owed to other Co-operative Bank undertakings	-	-	-	-	3,186.4	-	3,186.4
Other liabilities	-	-	-	-	44.8	-	44.8
Total financial liabilities	204.4	77.4	-	-	28,548.0	198.8	29,028.6
Non-financial liabilities							585.0
Total liabilities							29,613.6
Capital and reserves							1,241.9
Total liabilities and equity							30,855.5

The 2015 comparatives have been restated as described in note 1 to the Company financial statements.

a) Use of financial instruments
Refer to note 38 in the Bank financial statements for details for 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:			
	Level 1	**Level 2**	**Level 3**	**Total**
2016				
Non-derivative financial assets				
Held for trading:				
Loans and advances to customers	**-**	**4.1**	**-**	**4.1**
Designated at fair value:				
Loans and advances to customers	**-**	**184.0**	**4.9**	**188.9**
Investment securities	**-**	**-**	**-**	**-**
Available for sale financial assets:				
Investment securities	**2,230.7**	**-**	**1,307.4**	**3,538.1**
Equity shares	**0.2**	**25.3**	**19.3**	**44.8**
Derivative financial assets	**-**	**261.2**	**-**	**261.2**
Non-financial assets				
Investment properties	**-**	**-**	**2.2**	**2.2**
Total assets carried at fair value	**2,230.9**	**474.6**	**1,333.8**	**4,039.3**
Non-derivative financial liabilities				
Designated at fair value:				
Customer accounts – capital bonds	**-**	**11.8**	**-**	**11.8**
Derivative financial liabilities	**-**	**434.2**	**61.6**	**495.8**
Total liabilities carried at fair value	**-**	**446.0**	**61.6**	**507.6**

	Fair value at end of the reporting period using:			
	Level 1	Level 2	Level 3	Total
2015				
Non-derivative financial assets				
Held for trading:				
Loans and advances to customers	-	4.2	-	4.2
Designated at fair value:				
Loans and advances to customers	-	168.5	5.5	174.0
Investment securities	582.4	-	-	582.4
Available for sale financial assets:				
Investment securities	2,697.0	-	1,599.8	4,296.8
Equity shares	0.1	2.4	51.2	53.7
Derivative financial assets	-	193.2	-	193.2
Non-financial assets				
Investment properties	-	-	2.1	2.1
Total assets carried at fair value	3,279.5	368.3	1,658.6	5,306.4
Non-derivative financial liabilities				
Designated at fair value:				
Customer accounts – capital bonds	-	77.4	-	77.4
Derivative financial liabilities	-	341.9	61.3	403.2
Total liabilities carried at fair value	-	419.3	61.3	480.6

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

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

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

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

Loans and advances to customers
Loans and advances to customers primarily relate to corporate loans of £178.1m (2015: £159.1m), which are fair valued through profit or loss using observable inputs. Loans held at fair value are valued at the sum of all future expected cash flows, discounted using a yield curve based on observable market inputs.

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

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

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

Equity shares
Equity shares relate to investments held in VocaLink Holdings Limited which are unquoted shares. For VocaLink, the valuation of these shares is based on offers received for the Company's shareholding as the best indicator of the fair value of these shares at the reporting date.

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 £4.9m (2015: £5.5m), which are fair valued through profit or loss using unobservable inputs. 25 year fixed rate mortgages are valued using future interest cash flows at the fixed customer rate and estimated schedule of customer repayments. Cash flows are discounted at a credit adjusted discount rate; the credit adjustment is based on the average margin of new long dated (five years or greater) fixed rate business written in the last six months, and subject to quarterly review. The eventual timing of future cash flows may be different from that forecast due to unpredictable customer behaviour, particularly on a 25 year product. The valuation methodology takes account of credit risk and has increased the valuation by £0.2m in 2016 (2015: £0.2m decrease). A reasonable change in the assumptions would not result in any material change in the valuation.

Investment securities – available for sale
Investment securities – available for sale include MBS of £1,307.4m (2015: £1,599.8m), which are fair valued through other comprehensive income. The Company uses an independent third party valuation agent which provides prices obtained from large financial institutions. These prices are indicative values only and do not represent an offer to purchase the securities.

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

A 1% increase or decrease in the price of the notes will result in the value increasing or decreasing by approximately £13.0m respectively.

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

If the illiquidity premium to the discount rate was assumed to be double, it would result in a reduction in the overall fair value of the equity shares of £3.5m (18.1%) at 31 December 2016. Therefore, this valuation model is not deemed to be materially sensitive to this input, with a 100% increase resulting in an 18.1% change in valuation.

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

Derivative liabilities
As part of a synthetic securitisation structure the Company has entered into credit default swaps with two of its subsidiaries, Platform Funding Ltd and Calico Finance Number One Limited. The CDSs are valued by an independent third party value agent and are subject to a range of estimations which include recovery rates, the mortgage portfolio hazard rate and mortgage portfolio correlation, all of which introduce uncertainty to the estimation of the fair value. As these CDSs are wholly internal to the consolidated Bank, there are no external parties or markets affected by the valuation assumptions. Under certain circumstances the option exists to call the externally issued notes early and collapse the structure, at which point the notional amount of the derivatives would contractually revert to zero without any break fees payable by any of the companies involved. The methodology applied by the Company provides a best estimate of the fair value of the CDSs given the inherent uncertainties.

There are two significant assumptions used in the modelling of the Calico valuation: the recovery rate and the correlation level between the mezzanine tranche and the other tranches in the structure. A correlation rate of 50% has been used in the valuation, which is our best estimate. If this assumed correlation changes by 10%, the valuation is estimated to decrease (for a higher correlation) or increase (for a lower correlation) by £5.0m (8.1%). The recovery rate used is the average of the actual monthly recovery rates. In 2016 this was 78.7% (2015: 77.7%). For every 1% change in the recovery rate, the valuation is estimated to increase (for a higher percentage) and decrease (for a lower percentage) by £1.0m (1.6%).

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, transfers out and repayments	Other comprehensive income	Income statement	Fair value at the end of the year
2016						
Loans and advances to customers	**5.5**	**-**	**(0.8)**	**-**	**0.2**	**4.9**
Derivative liabilities	**(61.3)**	**-**	**-**	**-**	**(0.3)**	**(61.6)**
Investment securities	**1,599.8**	**-**	**(306.5)**	**9.0**	**5.1**	**1,307.4**
Equity shares	**51.2**	**16.1**	**(58.2)**	**13.5**	**(3.3)**	**19.3**
Investment properties	**2.1**	**-**	**(0.1)**	**-**	**0.2**	**2.2**
Amounts owed to other Co-operative Bank undertakings	**-**	**-**	**-**	**-**	**-**	**-**
	1,597.3	**16.1**	**(365.6)**	**22.5**	**1.9**	**1,272.2**
2015						
Loans and advances to customers	6.7	-	(1.0)	-	(0.2)	5.5
Derivative liabilities	(67.5)	-	-	-	6.2	(61.3)
Investment securities	-	1,685.5	(86.8)	1.1	-	1,599.8
Equity shares	-	-	-	51.2	-	51.2
Investment properties	2.1	-	(0.1)	-	0.1	2.1
Amounts owed to other Co-operative Bank undertakings	(1,126.0)	-	1,088.3	-	37.7	-
	(1,184.7)	1,685.5	1,000.4	52.3	43.8	1,597.3

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 in note 1 of the Bank financial statements.

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.

	Carrying value	Fair value
2016		
Financial assets		
Cash and balances at central banks	**2,848.2**	**2,848.2**
Loans and advances to banks	**619.1**	**619.1**
Loans and advances to customers	**19,100.4**	**18,378.9**
Fair value adjustments to hedged risk	**131.6**	**131.6**
Investment securities	**34.8**	**35.4**
Amounts owed by other Co-operative Bank undertakings	**1,106.3**	**1,177.4**
Other assets	**148.9**	**148.9**
Financial liabilities		
Deposits by banks	**1,198.6**	**1,198.6**
Customer accounts	**22,558.5**	**22,602.5**
Debt securities in issue	**1,006.8**	**1,058.8**
Other borrowed funds	**472.6**	**363.6**
Amounts owed to other Co-operative Bank undertakings	**2,141.0**	**2,127.7**
Other liabilities	**44.9**	**44.9**

	Carrying value	Fair value
Restated 2015		
Financial assets		
Cash and balances at central banks	2,670.1	2,670.1
Loans and advances to banks	452.1	452.1
Loans and advances to customers	12,302.9	12,309.1
Fair value adjustments to hedged risk	94.0	94.0
Investment securities	66.1	70.5
Amounts owed by other Co-operative Bank undertakings	8,322.8	8,375.3
Other assets	192.8	192.8
Financial liabilities		
Deposits by banks	715.9	715.9
Customer accounts	23,135.3	23,140.4
Debt securities in issue	1,005.7	1,063.1
Other borrowed funds	459.9	498.7
Amounts owed to other Co-operative Bank undertakings	3,186.4	3,215.6
Other liabilities	44.8	44.8

The 2015 comparatives have been restated as described in note 1 to the Company financial statements.

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

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

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

Loans and advances to customers
The fair value of loans and advances to customers in total is 96% of the carrying value as at 31 December 2016 (2015: 100%). The movement is more pronounced than in Bank due to the large transfer of loans and advances to customers to Company from a number of its subsidiaries during the year, which has changed the mix of the loan book. The majority of the Optimum Non-core loans - which have lower fair value compared to Retail and corporate – are now in Company, compared to none in 2015.

The loans transferred into the Company were previously funded by an inter-company liability to the Company from its subsidiary entities. This inter-company receivable in the Company balance sheet had a fair value equal to its carrying value, due to the fact that these amounts were repayable on demand and additionally had limited credit risk exposure given the Bank's continued documented support for its subsidiary entities. Therefore, exchanging the inter-company receivable for these loans and advances to customers led to an overall material decline in the calculated fair value of the Company's assets.

The overall fair value is less than par primarily due to two main factors for Non-core loans in particular:

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

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

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

Other reporting entities may use different valuation methodologies and assumptions in determining fair values for which no observable market prices are available.

Investment securities
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.

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

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

Amounts owed to other Co-operative Bank undertakings
Amounts owed to other Co-operative Bank undertakings relate to deemed loans owed to the Company's own securitisation vehicles, these have been modelled using expected cash flows, based on redemption profiles, discounted at a market rate.

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

		Fair Value		
	Carrying value	**Level 1**	**Level 2**	**Level 3**
2016				
Financial assets				
Cash and balances at central banks	**2,848.2**	**-**	**2,848.2**	**-**
Loans and advances to banks	**619.1**	**-**	**619.1**	**-**
Loans and advances to customers	**19,100.4**	**-**	**-**	**18,378.9**
Fair value adjustment for hedged risk	**131.6**	**-**	**-**	**131.6**
Investment securities	**34.8**	**35.4**	**-**	**-**
Amounts owed by other Co-operative Bank undertakings	**1,106.3**	**-**	**691.5**	**485.9**
Financial liabilities				
Deposits by banks	**1,198.6**	**-**	**1,198.6**	**-**
Customer accounts	**22,558.5**	**-**	**16,429.9**	**6,172.6**
Debt securities in issue	**1,006.8**	**1,058.8**	**-**	**-**
Other borrowed funds	**472.6**	**-**	**363.6**	**-**
Amounts owed to other Co-operative Bank undertakings	**2,141.0**	**-**	**-**	**2,127.7**

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

		Fair Value		
	Carrying value	Level 1	Level 2	Level 3
Restated and re-presented 2015				
Financial assets				
Cash and balances at central banks	2,670.1	-	2,670.1	-
Loans and advances to banks	452.1	-	452.1	-
Loans and advances to customers	12,302.9	-	-	12,309.1
Fair value adjustment for hedged risk	94.0	-	-	94.0
Investment securities	66.1	70.5	-	-
Amounts owed by other Co-operative Bank undertakings	8,322.8	-	853.3	7,522.0
Financial liabilities				
Deposits by banks	715.9	-	715.9	-
Customer accounts	23,135.3	-	23,140.4	-
Debt securities in issue	1,005.7	1,063.1	-	-
Other borrowed funds	459.9	-	498.7	-
Amounts owed to other Co-operative Bank undertakings	3,186.4	-	-	3,215.6

The 2015 comparatives have been restated as described in note 1 to the Company financial statements the level disclosure for debt securities in issue have been re-presented to better reflect how the fair value was determined.

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 fair value position**
2016					
Investments securities sold under repurchase agreements	**1,260.1**	**1,169.3**	**1,260.1**	**1,169.3**	**90.8**
2015					
Investments securities sold under repurchase agreements	721.7	671.2	721.7	671.2	50.5

Assets sold under repurchase agreements include mortgage backed securities (£426.5m of assets and associated liabilities of £336.1m) and UK government gilts (£833.6m of assets and associated liabilities of £833.2m).

28. Company analysis of credit risk exposure

			Investment securities				
2016	**Loans and advances to banks**	**Loans and advances to customers**	**Loans and receivables**	**Available for sale**	**Fair value through profit or loss**	**Derivative financial instruments**	**Total**
Analysis of balance in note	**5**	**6a**	**7a**	**7b**	**7c**	**8**	
Gross balance	**619.1**	**19,421.7**	**34.8**	**3,538.1**	**-**	**261.2**	**23,874.9**
Less: allowance for losses	**-**	**(128.3)**	**-**	**-**	**-**	**-**	**(128.3)**
	619.1	**19,293.4**	**34.8**	**3,538.1**	**-**	**261.2**	**23,746.6**
Analysis of credit risk exposure							
Not impaired	**619.1**	**18,702.5**	**34.8**	**3,538.1**	**-**	**261.2**	**23,155.7**
Impaired	**-**	**719.2**	**-**	**-**	**-**	**-**	**719.2**
	619.1	**19,421.7**	**34.8**	**3,538.1**	**-**	**261.2**	**23,874.9**
Credit commitments		**2,441.7**	**-**	**-**	**-**	**-**	**2,441.7**
Gross credit risk exposure	**619.1**	**21,863.4**	**34.8**	**3,538.1**	**-**	**261.2**	**26,316.6**
Less allowances for losses	**-**	**(128.3)**	**-**	**-**	**-**	**-**	**(128.3)**
Net credit risk exposure	**619.1**	**21,735.1**	**34.8**	**3,538.1**	**-**	**261.2**	**26,188.3**

			Investment securities				
2015	Loans and advances to banks	Loans and advances to customers	Loans and receivables	Available for sale	Fair value through profit or loss	Derivative financial instruments	Total
Analysis of balance in note	5	6a	7a	7b	7c	8	
Gross balance	452.1	12,709.8	66.1	4,296.8	582.4	193.2	18,300.4
Less: allowance for losses	-	(228.7)	-	-	-	-	(228.7)
	452.1	12,481.1	66.1	4,296.8	582.4	193.2	18,071.7
Analysis of credit risk exposure							
Not impaired	452.1	12,107.3	66.1	4,296.8	582.4	193.2	17,697.9
Impaired	-	602.5	-	-	-	-	602.5
	452.1	12,709.8	66.1	4,296.8	582.4	193.2	18,300.4
Credit commitments	-	2,246.5	-	-	-	-	2,246.5
Gross credit risk exposure	452.1	14,956.3	66.1	4,296.8	582.4	193.2	20,546.9
Less allowances for losses	-	(228.7)	-	-	-	-	(228.7)
Net credit risk exposure	452.1	14,727.6	66.1	4,296.8	582.4	193.2	20,318.2

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 Credit Risk section within Risk Management apply to the Company where relevant and therefore no additional disclosures are included in this note.

29. Events after the balance sheet date

- The Bank announced on 26 January 2017 that it expected its CET1, in the absence of any management actions, to fall and remain below 10% over the medium term. It is also unlikely to meet its Individual Capital Guidance (ICG) over the planning period to 2020. The Bank expects to meet its Pillar 1 capital requirements and to maintain sufficient liquidity to meet its obligations.

- On 13 February 2017 the Company announced that it was commencing a full sale process, inviting offers for 100% of its issued share capital and was also considering other options to build capital and meet the longer term capital requirements applicable to all UK Banks. Further details are set out in the Strategic report to the Bank Annual Report and Accounts.

- Effective 10 February 2017, the Company agreed amended contractual arrangements with its outsourced mortgage provider, and accordingly provisions for associated liabilities have been recognised in the financial statements.

Other Information

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SHAREHOLDER INFORMATION

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Forward-looking statements

Caution about Forward Looking Statements
This document contains forward looking statements with respect to the business, strategy and plans of The Co-operative Bank plc (including its 2017-2021 Strategic Plan or the Plan) and its current targets, goals and expectations relating to its future financial condition, performance, developments and/or prospects. In particular, it includes targets in the '2017 outlook & longer term targets' outlined in 'Detailed Financial Review: Outlook' and information about a potential LME/capital raise (the Capital Raising) that the Bank is considering as an alternative to the sale of the Bank. Forward-looking statements sometimes use words such as 'may', 'will', 'seek', 'continue', 'aim', 'anticipate', 'target', 'projected', 'expect', 'estimate', 'intend', 'plan', 'goal', 'believe', 'achieve', 'predict', 'should' or in each case, their negative or other variations or comparable terminology, or by discussion of strategy, plans, objectives, goals, future events or intentions. Examples of such statements include statements regarding the Bank's future financial position, net interest margin growth, targeted non-interest income, operating costs, project costs, RoE, RWAS, assets, impairment charges, business strategy, capital ratios, including CET1 ratios and targets, Pillar 2a targets, leverage, excess capital targets, payment of dividends, projected costs, commitments in connection with the Plan, estimates of capital expenditures and plans and objectives for future operations and other statements that are not historical fact.

Limitations inherent to forward-looking statements

The Bank cautions readers that these forward–looking statements are not historical facts or guarantees of future performance. By their nature, forward looking statements involve risk and uncertainty because they are based on current plans, estimates, targets, projections, views and assumptions and are subject to significant inherent risks, uncertainties and other factors both external and internal relating to the Bank's Plan, strategy or operations, which may result in the Bank being unable to achieve the current targets, predictions, expectations and other anticipated outcomes expressed or implied by these forward-looking statements. In addition, certain of these disclosures are dependent on choices relying on key model characteristics and assumptions and are subject to various limitations, including assumptions and estimates made by management. Accordingly, undue reliance should not be placed on forward-looking statements.

Important factors that could affect the actual outcome of the forward-looking statements

The Bank cautions you that a large number of important factors could adversely affect the Bank's operating results and financial condition or the Bank's ability to implement its Plan, cause us to miss our targets, predictions and anticipated outcomes or affect the accuracy of forward-looking statements. These include the risks and uncertainties summarised in the 'Principal Risks and Uncertainties' section of this annual report. These include the significant risks and factors such as:

- the Bank's ability to continue as a going concern;
- whether the Bank's regulators and supervisory authorities will exercise any of their various powers including to impose a special resolution procedure on the Bank under the Banking Act 2009;
- whether or not the Bank will successfully complete a sale of the Bank or the Capital Raising on acceptable terms, when needed, or at all;
- whether the Capital Raising will raise the amount of CET1 capital contemplated in the Plan, when needed, on acceptable terms, or at all, following a failure or perceived failure to sell the Bank;
- the Bank's ability to obtain requisite regulatory, shareholder and bondholder approvals and agree and sign definitive documents on acceptable terms and market conditions to effect the sale of Capital Raising;
- the Bank's ability to respond to a change in its business and environment and successfully deliver all or part of the Plan and desired strategy when planned or targeted;
- the Bank's ability to complete the transformation programme when planned and in line with target costs;
- whether any deficiencies in appropriate governance and related programme management processes would impede the satisfactory delivery of the transformation programme when planned and in line with targeted costs which would impact associated cost reductions or income generation plans;
- the extent of the amounts the Bank will be required to pay in pension fund deficits;
- the effect of uncertainties, including any press speculation, surrounding the sale of the Bank or the Capital Raising and any potential negative impact on the Bank's reputation and business;
- the Bank's ability to successfully deliver important management actions other than the sale of the Bank or the Capital Raising and parts of it Plan when planned or targeted;
- whether base rates will increase as soon as and as much as the Bank is forecasting in its Plan or whether competitive pressures reduce the Bank's market share or do not enable net interest margins to increase as envisaged in the Plan or that regulatory pressure constrain the anticipated growth in volumes;
- whether growth in new mortgage origination is significantly less than assumed in the Plan;
- whether the Bank can access liquidity and funding at an appropriate cost to fund the requisite level of asset origination targeted in the Plan, including the risk that the Bank may be unable to gain access to current or future central bank funding facilities and initiatives;
- whether assets in the Bank's Legacy Portfolio can be sold on acceptable terms, or at all;
- greater than planned losses identified in the Plan on any remaining asset sales;
- changes in the business, such as fee changes result in cash outflows and a lower than expected overall non-interest income;
- significant new conduct or legal risk provisions during the life of the Plan;
- whether RWAs remain significantly greater than those targeted in the Plan due to worsening economic conditions and the risk that any material increases in RWAs will significantly increase our capital requirements;
- whether the Bank will achieve intended cost reductions when planned, or at all;
- operating costs being higher than assumed in the Plan, particularly in the latter half of the Plan;

- the Bank's cost:income ratio continuing to negatively impact its profitability and its capital position;
- whether the Bank will be able to achieve ICG compliance when planned;
- whether the Bank will complete a £250 million Tier 2 debt issuance in 2018 and MREL qualifying debt issuances in 2010 and 2021 when planned, on acceptable terms, or at all;
- the PRA or other regulators exercising their discretion and withdrawing their support for the Bank or its Plan;
- whether the Bank is able to recognise the amount of deferred tax assets stated in the Plan and generates the profits after tax targeted in the Plan when expected, or at all;
- the Bank's ability to remedy its regulatory deficiencies and weaknesses in the Bank's Risk Management Framework;
- the Bank's management of credit risk, interest rate risk, currency risk and market risk;
- the Bank's ability to meet its regulatory capital and MREL requirements;
- the Bank's approach to modelling its credit risk capital requirements;
- a borrower's failure to meet the terms of any contract with the Bank or failure to perform as agreed;
- liquidity and funding risk, the Bank's inability to meet its contractual liabilities as a result of inadequate resources or cash outflows that may occur under stress;
- market-related risks, including but not limited to changes in the market prices of financial instruments;
- operational risks, including inadequate or failed internal processes, people and systems, or external events;
- risk of regulatory scrutiny and investigations into failure to comply with regulatory requirements which could result in exposure to fines, public censure, litigation, limitation on business, legal or operational restructuring, or restitution costs;
- exposure to reputational risks and conduct risks which could, for example, arise as a result of the Bank's strategic decisions or business performance, an operational failure or external perception;
- ability to attract, recruit and retain skilled personnel within the Bank;
- the effect of the Bank's exposure to scheme liabilities and its related risks on the Bank's capital, funds and assets; and
- negative changes to the Bank's credit ratings.

In addition, there are other risks and uncertainties that could adversely affect the Bank's results, ability to implement its Plan, cause it to miss its targets or the accuracy of forward-looking statements. These include but are not limited to: deterioration in general economic conditions in the UK and internationally; inflation, deflation, interest rates and policies of the Bank of England, the European Central Bank and other G8 central banks; instability in global financial markets including fluctuations in exchange rates, stock markets and currencies; the UK's impending departure from the EU which may occur as early as April 2019 and any consequential regulatory capital or liquidity requirements or similar contingencies outside of the Bank's control; further clarity around future regulatory requirements, including expectations regarding MREL requirements; a possible contraction in the UK mortgage market negatively impacting loan book growth, systemic capital markets volatility; the UK banks' reaction to the Bank of England stimulus package; higher unemployment and lower property prices; risks stemming from any regulatory change, increasing regulatory enforcement and an increasingly litigious environment; changing demographic developments, including mortality and changing customer behaviour, including consumer spending, saving and borrowing habits; changes to borrower or counterparty credit quality; technological changes and risks to cyber security; natural and other disasters, adverse weather and similar contingencies outside the Bank's control; terrorist acts and other acts of war or hostility and responses to those acts; and geopolitical, pandemic or other such events; and impact of changes in laws, regulations, taxation, accounting standards (including, with effect from 1 January, IFRS 9) or practices in the UK, the EU, the US or elsewhere including the implementation and interpretation of key legislation and regulation, following the recommendations made by the Independent Commission on Banking.

Forward-looking statements speak only as at today

Any forward-looking statements made or contained in this annual report speak only as of the date of this annual report and it should not be assumed that they have been revised or updated in the light of new information of future events. Except as required by the Prudential Regulation Authority, the Financial Conduct Authority, the London Stock Exchange or applicable law, the Bank expressly disclaims any obligation or undertaking to release publicly any updates or revisions to any forward-looking statements contained in this document to as a result of new information or to reflect any change in the Bank's expectations with regard thereto or any change in events, conditions or circumstances on which any such statement is based. The reader should, however, consider any additional disclosures that the Bank has made or may make in documents it has published or may publish via the Regulatory News Service of the London Stock Exchange.

No offer of securities

The information in this annual report is not, nor should be construed as, an offer of, or solicitation of an offer to purchase or subscribe for, any securities to any person in any jurisdiction. In particular, this annual report does not constitute an offer for sale of, or a solicitation to purchase or subscribe for, any securities in the United States. No securities of the Bank have been, or will be, registered under the US Securities Act of 1933, as amended (the Securities Act), and securities of the Bank may not be offered or sold in the United States absent an exemption from, or in a transaction not subject to, the registration requirements of the Securities Act and in compliance with any applicable securities laws of any state or other jurisdiction of the United States.

APPENDIX 1
EDTF recommendations
For the year ended 31 December 2016

The table below provides an index to the Bank's disclosures in accordance with the EDTF's recommendations either within its Annual Report and Accounts or Pillar 3 disclosures.

Type of risk	Recommendation	Disclosure	Section in Pillar 3	Section in Risk Management within the ARA	Related sections of the ARA
General	1	Risks to which the business is exposed	5	Risk Management objectives and policies 1.1-1.5	Strategic report
	2	Definition of risk terminology, principles and appetite	5		
	3	Top and emerging risks and the changes during the reporting period	5		
	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	4	Risk Management objectives and policies 1.1-1.5 Capital Management	Strategic report
	6	Risk culture and risk governance and ownership	4		
	7	Key risks, risk appetite and risk management	4, 5		
	8	Stress testing and the underlying assumptions	3		
Capital adequacy	9	Minimum Pillar 3 disclosure requirements	3	Capital Management	
	10	Reconciliation of accounting balance sheet to regulatory balance sheet	3		
	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	3		
	12	Discussion of targeted level of capital and how this will be established	1,3, 5		
	13	Analysis of Risk Weighted Assets	3		
	14	Analysis of capital requirements for each Basel asset class	3		
	15	Analysis of credit risk for each Basel asset class	3		
	16	Flow statements reconciling the movements in Risk Weighted Assets for each Risk Weighted Asset type	3		
	17	Discussion of Basel credit risk model performance	5		
Liquidity and funding	18	Analysis of the Bank's liquid asset buffer	5	Liquidity risk	
	19	Encumbered and unencumbered assets analysed by balance sheet category	5		
	20	Consolidated total assets, liabilities and off-balance sheet commitments analysed by remaining contract maturity at the balance sheet date	5		
	21	Analysis of the Bank's sources of funding	5		
Market risk	22	Relationship between the market risk measures for trading and non-trading portfolios and the balance sheet	5	Market risk	
	23	Discussion of trading significant trading and non-trading market risk factors	5		
	24	VaR assumptions, limitations and validation	5		
	25	Description of the primary risk management techniques employed by the Bank	5		

Credit risk	26	Analysis of the aggregate credit risk exposures	5	Credit risk 2.1-2.3	Note 15: loans and advances to banks
	27	Describe the policies for identifying impaired and non-performing loans	5	Credit risk 2.2	Note 16a: loans and advances to customers
	28	Reconciliation of the opening and closing balances of non-performing or impaired loans in the period	5	Credit risk 2.2	Note 17: investment securities
	29	Analysis of counterparty credit risk that arises from derivative transactions	5	Credit risk 2.2.4	Note 18: derivative financial instruments
	30	Discussion of credit risk mitigation, including collateral held for all sources of risk	5	Credit risk 2.2-2.3	
Other risks	31	Description of other risks	5	Pension risk, Regulatory risk, Conduct risk 5-7	Note 31: Provisions for liabilities and charges
	32	Discussion of publicly known risk events	5	Pension risk, Regulatory risk, Conduct risk 5-7	Note 34: Contingent liabilities and commitments