Working together

The Co-operative Bank p.l.c.

Financial Statements 2005

The Co-operative Bank
Customer led, ethically guided

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We have a branch opening programme planned for 2006.

Highlights

Financial

- The Co-operative Bank reported operating profits of £97.8m.
- Average retail customer lending balances grew by 8% and average retail customer deposit balances grew by 7% across the portfolio.
- Operating income increased by £21.7m (4%), the cost/income ratio improved by 0.8 percentage points, but impairment losses increased by £29.1m.
- Our Corporate Banking lending balances exceeded £2bn for the first time.

Business

- The Co-operative Bank was awarded ‘Business Lender of the Year’ at the Credit Today Awards for excellence in lending to small and medium sized businesses.
- Our Internet banking service, **smile**, was voted the ‘Best Overall for Customer Services’ and ‘Best Credit Card Provider’ at the Guardian/Observer Consumer Finance Awards.
- The Co-operative Bank’s first time buyer mortgage service took top honours at the Your Mortgage Awards.
- A plan aimed at sustainable growth in the Bank, including a branch-opening programme for 2006, has been launched.

Vision and values

Our business purpose

To be a growing, pioneering financial services business delivering benefits to customers, members and communities through commitment to value, fairness and social responsibility.

Our CFS vision

To be the UK's most admired financial services business.

Our values

As a Co-operative business, we believe in:

social responsibility

We are committed to leading the way on ethical, environmental and community issues.

openness and honesty

We work hard to earn credibility and trust from our customers and each other.

being successful

We work together to make sure that CFS is admired, profitable and sustainable.

being customer focused

We always aim to satisfy our customers and exceed their expectations where we can.

making work fun

We are proud of CFS and know we can contribute to making it a great place to work.

Chair's statement: investment in growth.

Graham Bennett
Chair

The combination of its Ethical Policy, excellent service, attractive product range and variety of service channels continue to differentiate The Co-operative Bank from the increasing competition.

In 2005 this produced income growth well ahead of cost growth creating a 6.8% improvement in operating profit before impairment losses compared to 2004. Average retail customer lending balances increased by 8%, reflecting a growth in mortgages and corporate balances, whilst average retail customer deposit balances grew by 7% across the portfolio.

In line with other banks, consumer bad debt was significantly higher than 2004 and contributed to a decrease in profit before tax to £96.5m, a reduction of £17.8m compared to 2004.

During the year we continued to invest in our products, branches and infrastructure to improve our customer service, and this has been reflected in external recognition. Our first time buyer mortgage service took top honours at the Your Mortgage Awards and the Bank was awarded 'Business Lender of the Year' for excellence in lending to small and medium sized businesses at the Credit Today Awards. This showed through in corporate lending with balances exceeding £2bn for the first time.

Our Internet banking service, **smile**, was voted the 'Best Overall for Customer Services' and 'Best Credit Card Provider' at the prestigious Guardian/Observer Consumer Finance Awards. For the fourth year running **smile** also won 'Best Online Banking Provider' at the Your Money Direct Awards.

We are confident of the future success of The Co-operative Bank and that the coming year will be an exciting one as the Bank begins to implement its investment plans and completes its integration with its sister company, Co-operative Insurance Society (CIS) creating a single, customer-focused business.

The Co-operative Bank is part of the Co-operative Group, and last year the Group made a commitment to return a share of its profits to all of its members. This was successfully delivered in October 2005 to over 550,000 members. The payment was linked to the amount of trade the member had transacted with the Group, including The Co-operative Bank.

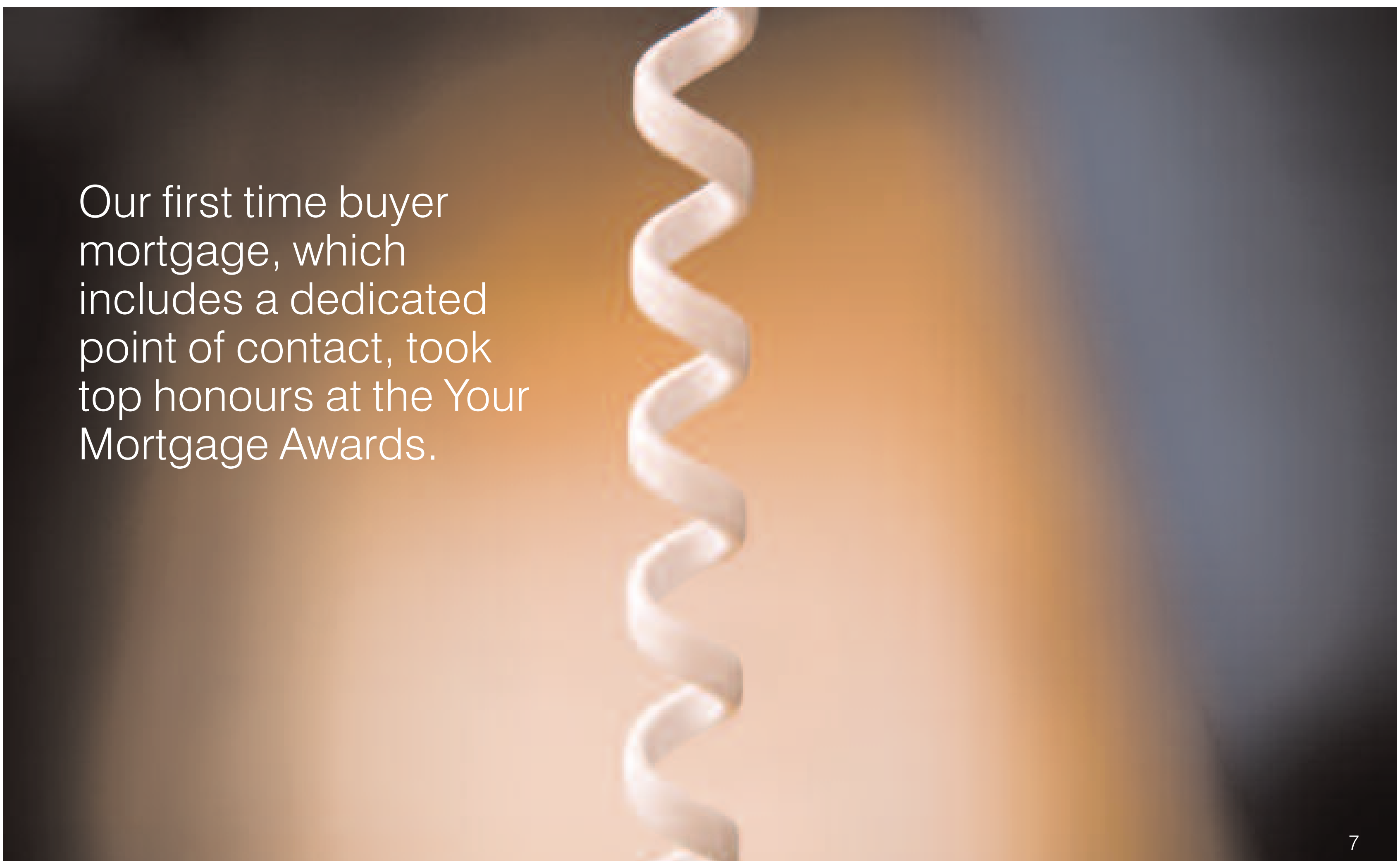
Alongside this, the Bank and the Group have been working on the development of a new common brand identity to enable a wider customer base to understand the family of businesses. This is an exciting and important initiative to bring us closer together and I look forward to the positive impact this will have on our business.

We have announced plans to modify the Co-operative Group's pension scheme including the pension schemes which operate in The Co-operative Bank and CIS. Like all UK businesses, the Group has found that the cost of providing pensions has increased substantially in recent years. Many UK employers have reviewed their pension arrangements and chosen to offer a Defined Contribution scheme which links final pension to unpredictable investment performances – a risk which would be carried by employees. The Group has instead introduced a new pension scheme which is based on annually revalued career average earnings, where the employer, not the employee, carries the investment risk.

I would like to take this opportunity to welcome to the Board Piers Williamson, Non-Executive Director.

Finally, I would like to thank Richard Goddard, Finance & Risk, who stood down from the Board at year end as a result of taking up the position of Director of Financial Control in CFS. I would also like to thank John Marper, CFS Risk & Compliance and Peter Sutcliffe, Retail Banking, Business Management, who both retired from the Board at year end. In addition, I would particularly like to thank Sheila Macdonald, Chief Operating Officer, who retired from the Bank after 40 years service in January 2006. The Board would like to record its thanks to Sheila for her services and contribution to the business.

Graham Bennett, Chair



Our first time buyer mortgage, which includes a dedicated point of contact, took top honours at the Your Mortgage Awards.

We are actively developing new products for a range of consumers.

Chief Executive's overview: customer focused integration.

David Anderson
Chief Executive

Much of the work undertaken within The Co-operative Bank over the last twelve months has involved laying the foundations for the full integration and future growth of Co-operative Financial Services, which includes the Bank and Co-operative Insurance Society (CIS).

In October 2005, we clarified the purpose of CFS: 'To be a growing, pioneering financial services business delivering benefits to customers, members and communities through commitment to value, fairness and social responsibility', announced our long term, aspirational vision: 'To be the UK's most admired financial services business' and launched a 'Values Debate' amongst colleagues from across the organisation. The 'Values Debate' enabled colleagues to choose those values which they believe should underpin how we go about our business and the chosen values, as outlined at the beginning of this report, were unveiled in January 2006. All of these elements provide clarity on what we are in business to do, where we are heading in the future and how we will conduct our business – giving a solid platform on which to build success.

Our strategic plan for the coming years has been finalised and outlines both our long and short term objectives for the benefit of our key stakeholders; namely colleagues, customers, members; the community and the Co-operative Group. We have examined in detail how we need to run our business, provide opportunities for growth and integrate activities to create one financial services business going forwards.

Our journey towards our aspirational vision is underpinned by five key measures:

- Profit generation to create a sustainable model
- Market leading staff satisfaction
- Market leading customer satisfaction
- Market leading social responsibility approach
- Membership growth.

As part of our vision, our ultimate aim is to have the UK's most satisfied customers and colleagues, both of which are critical to our future success. There are a number of ways in which we intend to energise our colleagues and increase their satisfaction. For example, our recently introduced Employee Development Programme incorporates a series of self discovery learning toolkits to help colleagues across the business fulfil more of their potential and take responsibility for their own development. Colleague satisfaction and engagement will continue to be measured by our annual colleague survey and monitored throughout the year. Our latest survey results demonstrate a clear improvement in these areas along with an increased response rate of 62% compared with 45% in 2005.

Improving our customers' satisfaction is also being addressed in a number of ways. Within the Bank for example, initiatives are underway to update our infrastructure and deliver a faster payments environment. Our customers will benefit greatly from this activity which will provide faster electronic payments between accounts and enhanced online bill payment functionality. Our customer focus is also at the forefront of our development of a new IT system for Bank products, brands and channels and one of the benefits arising in the early stage of this project will include a more efficient account opening process. There are a number of key projects that will impact upon our future success and which require investment over the coming year. These will address our need to improve both our customer proposition, our systems and processes.

In 2005, the Bank started a series of initiatives designed to develop long-term customer relationships and to ensure the Bank has a profitable and successful future. The Bank is piloting an investment in five new branches and will assess the possible benefits of 'clustering', new store design and promotions.

In addition we are actively developing new products for a diverse cross-section of consumers to respond to their changing needs and demands. Inevitably, this has driven the requirement for our processes and procedures to be reviewed to ensure we can deliver the best possible service to all our customers.

We recognise the importance of developing strong customer relationships and are looking to address this whilst increasing the percentage of our customers who are also members of the Co-operative Group.

Working as a single organisation, we will focus on customers and members, converting customers to members through a proposition based on value, fairness and social responsibility. We will create sufficient profit to reward members, colleagues and communities and generate sustained growth.

We will create sufficient profit to reward members, colleagues and communities and generate sustained growth.

By clarifying our purpose, we are building a solid platform to achieve success.

In keeping with our co-operative heritage and our commitment to sustainable development, we will strive to continue to be market leaders on ethical and sustainability issues. Such an approach will continue to have at its core the implementation of our customer-mandated ethical policies, the development of sustainability initiatives and an ongoing commitment to 'warts and all' sustainability reporting. It will also emphasise the importance of listening to, and being responsive to, all our stakeholders.

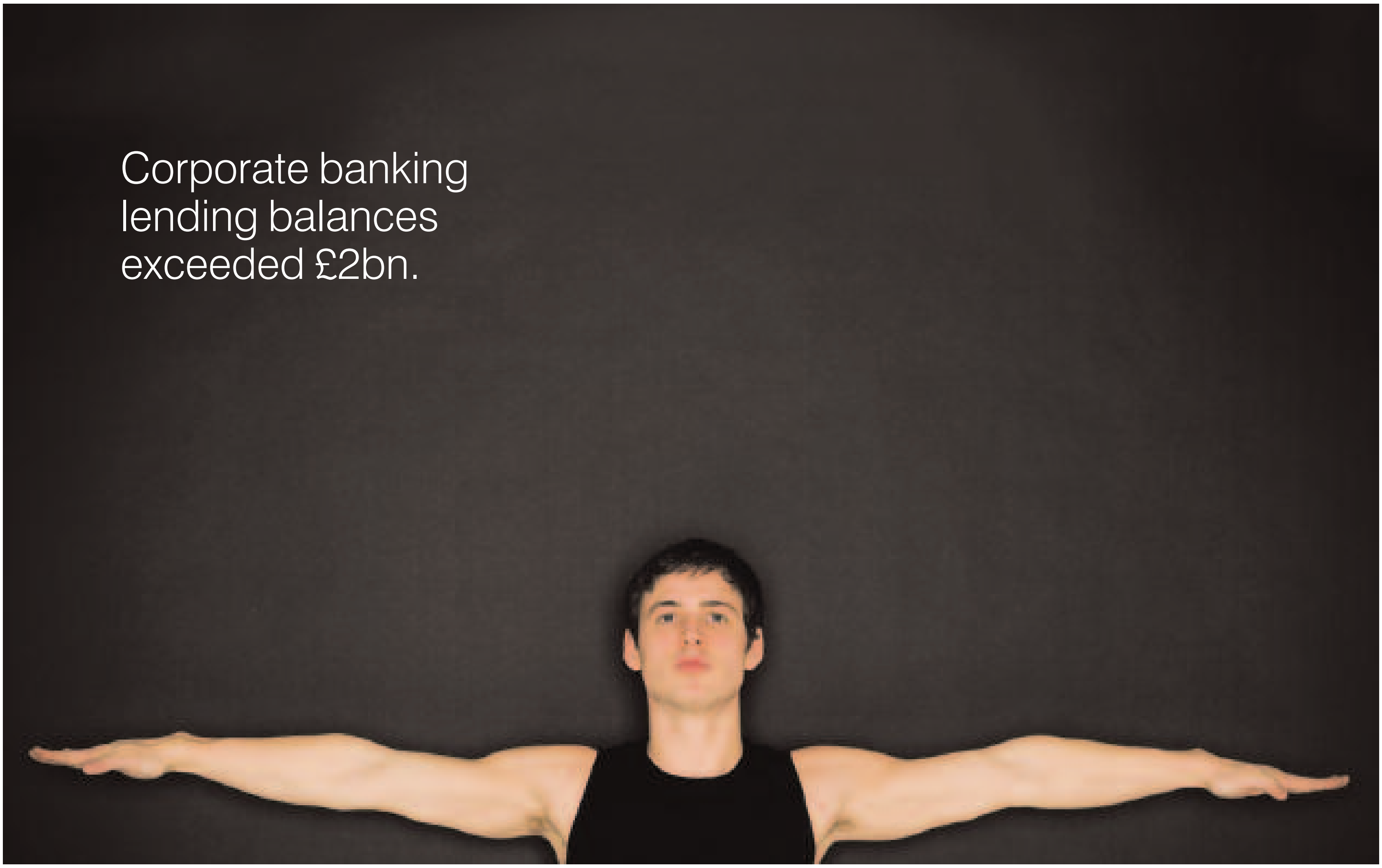
The backdrop against which the Bank has been working to build the foundations for the development of CFS has been a challenging one, not just for the Bank, but the industry as a whole, with increasing bad debt and a rise in the level of mandatory expenditure required to comply with regulatory demands such as Basel II.

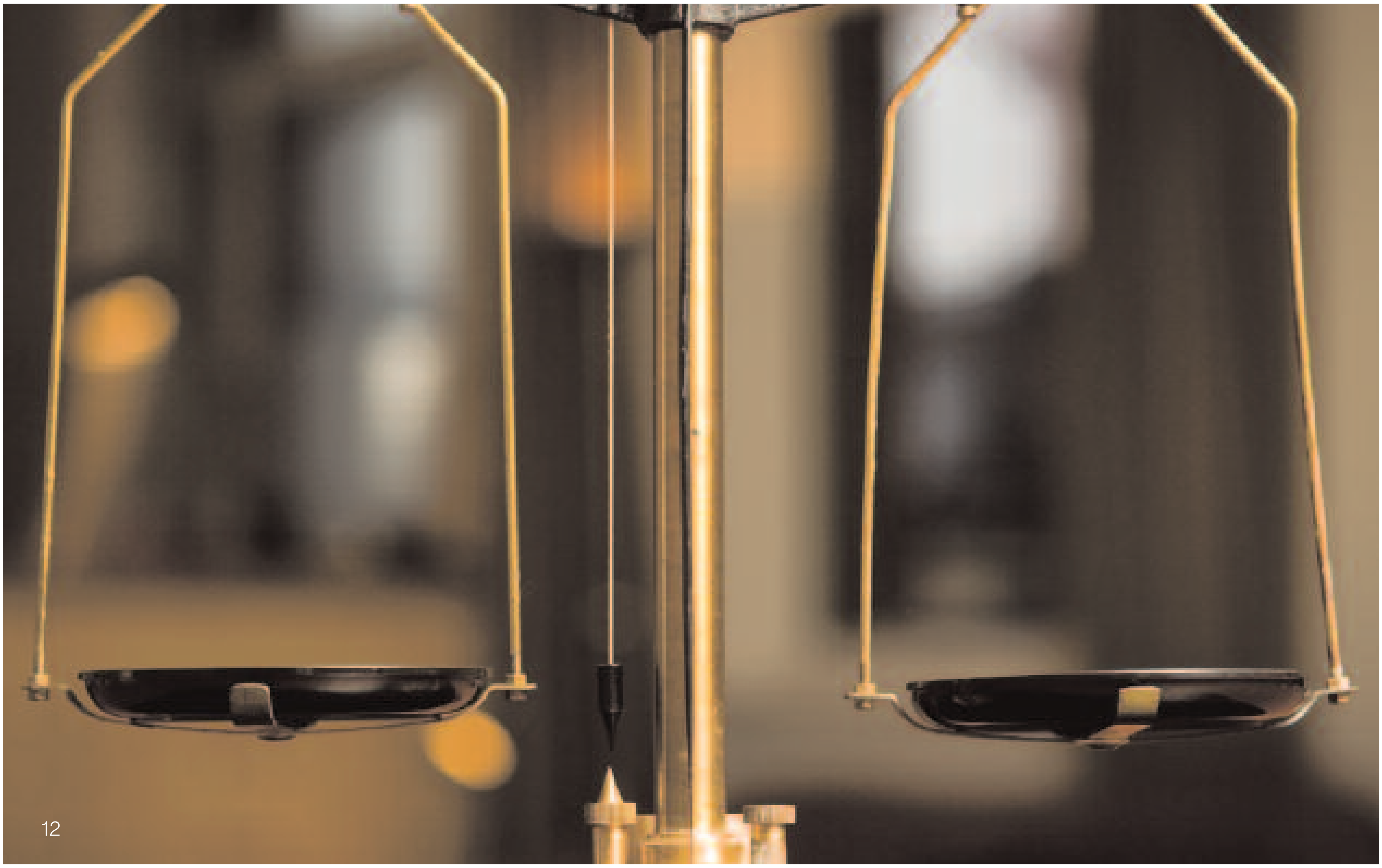
This is an exciting time for the Bank as it embarks on its programme to drive growth and fully integrate with CIS to create a single customer-focused business. In order for us to realise the benefits of becoming one organisation, our internal structure has been reorganised so our colleagues now undertake their work based around types of activity across CFS, rather than our insurance and banking arms of the business. This enables us to take a much more co-ordinated approach to our customers and be more responsive to their needs. Products and services will be joined together in more accessible ways for our customers so that, for example, our Co-operative Bank branches are able to provide advice and service in relation to all of our banking, general insurance and life and savings products.

In addition to ensuring we meet our customers' needs, we are also making a significant investment in customer management data to enable us to understand our customer preferences and allow us to target more effectively specific customers with relevant product offerings. Our drive towards achieving the integration of CFS will help us to be much more responsive to the needs of our customers and ensure we are better placed to achieve our vision.

We look forward to an exciting and successful future.

David Anderson, Chief Executive


Corporate banking
lending balances
exceeded £2bn.



Operating and financial review: balanced growth.

On 9 January 2005, in common with other EU listed entities, The Co-operative Bank implemented IFRS (International Financial Reporting Standards).

The information on pages 44 to 45 comprises a consolidated Income Statement and a consolidated Balance Sheet at 14 January 2006.

In compliance with the requirements of IFRS, the 'statutory' comparatives for 2004 can only include those standards implemented with effect from 11 January 2004. Consequently the 'statutory' comparatives exclude IAS32 'Financial Instruments: Disclosure and Presentation' and IAS39 'Financial Instruments: Recognition and Measurement', which were implemented with effect from 9 January 2005. The opening Balance Sheet at 9 January 2005 has been adjusted accordingly. In addition a statement of 'Transition to IFRS' detailing IFRS adjustments made to results previously reported under UK GAAP, including the effects of IAS32 and IAS39, is included on pages 50 to 51.

The basis of preparation of these financial statements and the accounting policies adopted are described in detail on pages 52 to 54. Included within this operating and financial review are 'proforma' results for the comparative year 2004, which show how the 2004 result would have looked including the application of IAS32 and IAS39, and assuming appropriate hedge documentation had been in place, to enable a more meaningful comparison of performance. All comments in the operating and financial review on year-on-year movements are based on the 'proforma' numbers for the previous year.

Financial highlights

The Co-operative Bank reported a profit before taxation of £96.5m and a return on opening equity (after tax) of 11.6% for the 53 weeks ended 14 January 2006. The Bank has achieved growth in both deposit and lending balances, particularly in the corporate and residential mortgage sectors, developing a greater proportion of secured lending on the balance sheet. This growth has been achieved without compromising the Bank's cautious lending criteria.

The decline in profit before tax of £17.8m compared to the previous year reflects a higher impairment charge due to the deteriorating personal consumer credit environment.

In addition, for the first time, a distribution of profit has been made to members of the Co-operative Group based on their account holdings with the Bank. Operating profit before impairment losses and membership dividend was £197.6m, higher than last year by £12.6m (7%), reflecting income growth of £21.7m (4%) and a 0.8 percentage point improvement in the cost/income ratio.

The increase in income has been achieved despite difficult market conditions in the retail banking sector, with consumer lending growing at a slower pace and continued pressure on margins. Although strong growth was achieved in non-interest income, tighter lending margins and lower investment yields have mainly offset balance sheet growth within net interest income.

2005 has seen a significant increase in personal impairment charges, particularly for credit cards. The deterioration in the credit climate, at a time when unemployment and interest rates remain at historically low levels, appears to reflect the unprecedented level of consumer indebtedness and a significant rise in personal bankruptcies. Although the Bank has suffered an increase in impairment losses in common with its peers, strong controls over lending have been maintained through the application of advanced behavioural credit scoring systems and monitoring of customers' overall indebtedness. In recent years the Bank has adopted a cautious lending policy (supported by benchmarking studies) and has diversified the asset base by increasing the proportion of secured lending. The Bank has maintained a strong balance sheet with consistently robust liquidity and capital ratios.

Results summary	**2005 £m**	**2004 £m**	**Change £m**
Operating income	**526.4**	504.7	21.7
Operating costs	**(328.8)**	(319.7)	(9.1)
Operating profit before impairment losses	**197.6**	185.0	12.6
Impairment losses	**(99.8)**	(70.7)	(29.1)
Operating profit	**97.8**	114.3	(16.5)
Profit based payments to members of the Co-operative Group	**(1.3)**	–	(1.3)
Profit before tax	**96.5**	114.3	(17.8)
Operating profit analysed by segment			
• Personal	**38.7**	58.4	(19.7)
• Corporate	**60.7**	50.0	10.7
• Wholesale	**14.8**	19.4	(4.6)
• Central costs	**(16.4)**	(13.5)	(2.9)
Operating profit	**97.8**	114.3	(16.5)
Cost/income ratio	**62.5%**	63.3%	0.8%

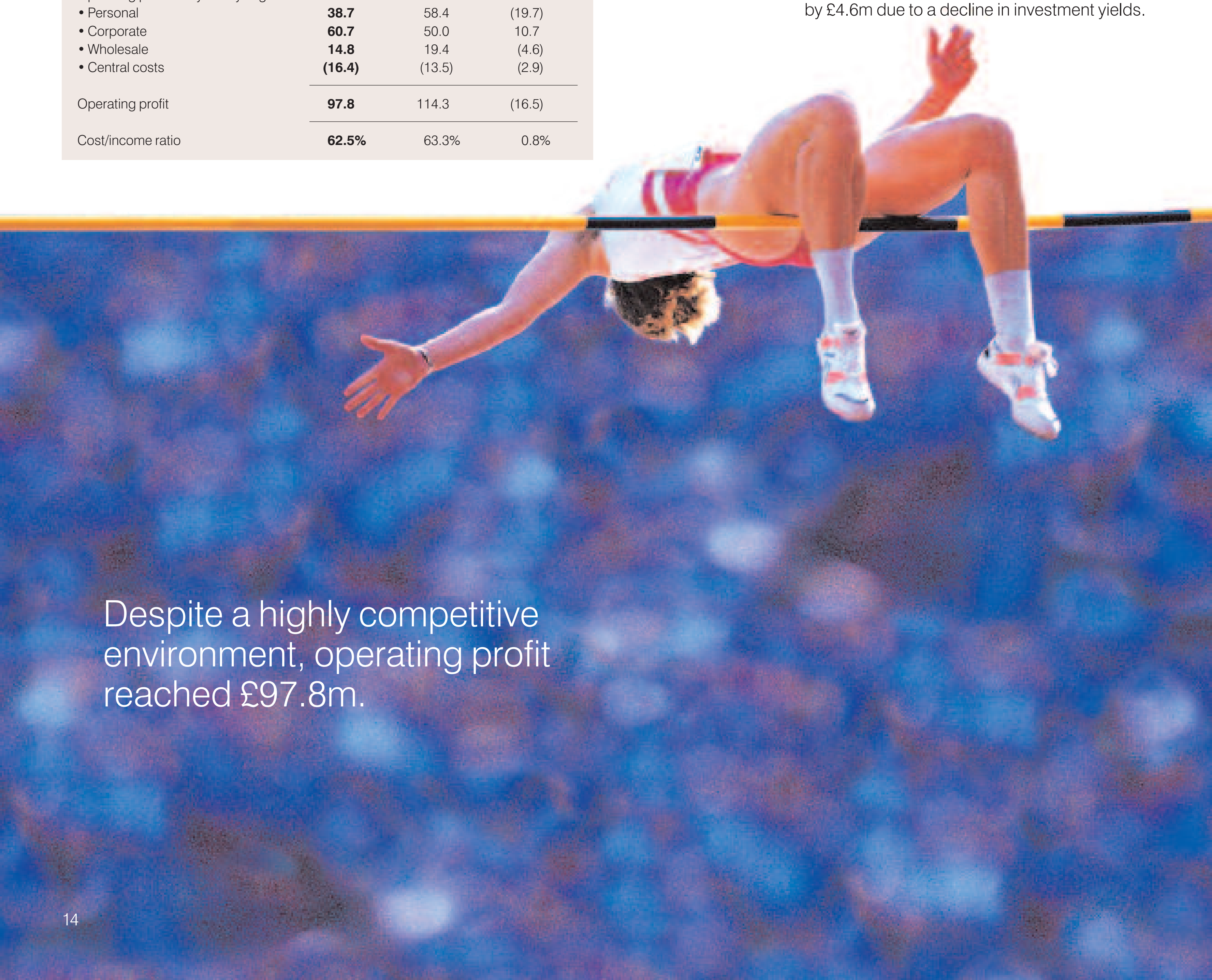
The year-end risk asset ratio was 14.8% with a tier I ratio of 9.9%, substantially higher than the regulatory requirements.

The Bank's profitability has been reasonably balanced between the personal sector and the corporate sector with a further significant contribution from the wholesale sector. In 2005, personal sector profitability has been adversely affected by the significant increase in the impairment charge.

Personal sector operating contribution before impairment charge increased by £12.0m due to growth in the mortgage income together with higher fees and commissions receivable, including fees from current accounts, LINK transaction fees and VISA commission.

Corporate sector operating contribution increased by £10.7m due to balance sheet growth and related transaction fees.

Wholesale sector operating contribution declined by £4.6m due to a decline in investment yields.



The UK economic growth rate declined in 2005, falling below the long-term trend level, as both business investment and consumer spending growth weakened. Whilst there has been some variability and inconsistency in recent economic indicators, the overall expectation is for a continuation of the relatively subdued economic activity in the UK in the short term. Although most commentators are anticipating a small reduction in interest rates, there is still some uncertainty with risks arising from further oil price rises and a downturn in the US economy. On the domestic front there is still potential for a sharp correction in the housing market, which poses a risk to both consumer confidence and spending, the principal drivers of UK economic growth in recent years.

Balance sheet

Average retail customer deposits of £7,031m grew by £465m (7%) over the year. Average customer retail lending balances increased by £592m (8%) to £7,566m principally due to growth in corporate and mortgage balances.

Retail lending

The personal lending market remained fiercely competitive during the year with some lenders offering unsustainable loss leading rates to obtain new customers when the demand for credit has been declining in the light of lower consumer spending and confidence. In this climate, the Bank continued its strategy of targeting growth at the residential mortgage market and holding market share in a subdued personal loans market, in order to improve asset mix whilst protecting asset quality and margins. Consequently, mortgage lending remained strong, achieving an 11% growth in average balances, whilst growth in unsecured consumer lending was lower.

The level of residential mortgage transactions has slowed during 2005 and house price inflation has been limited compared to the rates in earlier years. The Bank's own portfolio reflects this with organic growth slowing compared to the previous year. Although there have been significant tranches of mortgages coming to the end of offer periods during the year, the Bank has successfully retained a higher proportion of these accounts than expected through proactive customer contact and the development of profitable retention mortgage products. The Bank has also continued to develop the range of products, including a lifetime tracker, fixed, capped and discounted variable rate products and a comprehensive range of mortgages to help first time buyers. The Bank continues to maintain its strategy of responsible lending concentrating on low-risk prime sectors of the residential mortgage market. This strategy ensures a very low proportion of mortgages in arrears, significantly below the industry average published by the Council of Mortgage Lenders.

Retail unsecured asset balances were relatively stable with modest growth in credit card balances and personal loans reflecting the strategy of maintaining credit quality and margins against a background of slower consumer lending growth, competitive pressure on margins and increasing consumer indebtedness. The Bank successfully launched a new credit card, which offers a single rate for transactions regardless of source. This 'clear card' was created in response to consumer demand for a transparent and understandable product in the light of confusing headline price driven product offerings from competitors and is proving very popular.

Corporate

Average corporate lending balances increased to £2,089m, a satisfactory growth of 13% in a competitive market. This growth and diversification across a wide range of sectors has enabled the Bank to reduce total exposure to higher risk sectors including football. Growth was achieved across the portfolio with a continued involvement in the PFI sector and a leading role in the Global Commercial MicroFinance Consortium initiative sponsored by Deutsche Bank. The Bank continues to be recognised for both its products and customer service with awards in the year including 'Business Lender of the Year', awarded by the online credit magazine Credit Today, in recognition of the successful relationship established with the Federation of Small Businesses.

Deposits

Total average retail deposits increased by £465m to £7,031m, a satisfactory growth rate of 7%. Average personal sector deposits increased by £304m (7%) to £4,787m with growth across both current and savings account product ranges. During the year the Bank sold more tranches of its Guaranteed Stock Market Bond, which guarantees the capital invested and pays a return linked to the stock market. The Bank also continued to develop the portfolio of savings products including a Balanced Savings Plan, which combines a guaranteed fixed rate of interest and a return based on the growth in the stock market, and a new range of savings products. The new products include an instant access product and a base rate tracker product aimed at high net worth customers.

smile, the Bank's internet operation, which offers a comprehensive range of personal banking products, has grown steadily since its launch and average deposits increased a further 8% during the year. **smile** continues to win awards including the Your Money Direct award for 'Best Online Banking Provider' for the fourth year running and two awards, 'Best Overall for Customer Service' and 'Best Credit Card Provider', at the Guardian/Observer Consumer Finance Awards. **smile** will play a key role in our strategy to develop a single financial services provider.

Growth in corporate sector deposits was also encouraging with average balances reaching £2,244m, a growth rate of 8%. The Bank's bespoke product range for a variety of customer groups including SMEs, the voluntary sector, small businesses and co-operatives has continued to grow with services developed to match specific requirements. The Bank also provides vital support to the Post Office providing clearing services to enable replacement of postal orders. Work is also in progress to provide the members of ABCUL, the Trade Association for British Credit Unions, with basic current accounts, demonstrating the Bank's commitment to delivering products that meet the Government's pledge to improve access to finance.

Co-operative Financial Services (CFS)

During 2005, the Bank's sister organisation CIS focused on its comprehensive modernisation programme. Although this programme is by no means complete, 2006 will be a year to further develop our understanding of customers across CFS and to develop plans for the delivery of efficiency savings following the integration of the two organisations under one common management structure.

Along with other companies forming the CFS group, The Co-operative Bank aspires to be part of the UK's most admired financial services business and the ongoing programme to restructure and modernise the organisation is an important step towards that goal. Further initiatives planned for 2006 will ensure that the impetus to date is maintained. A key area of focus for 2006 will be the continuing development of one integrated financial services provider with a customer centric outlook. Now that the two organisations have been brought together we will be able to be much more responsive to the needs of our customers and ensure we are better placed to achieve our vision.

The Bank continues to maintain strong collaborative links with the wider Co-operative Group, including the management and operation of ATMs located in Co-operative Group retail stores. Over 300 machines were installed in 2005, bringing the total number in the retail network to over 2,400.

Operating income

Operating income of £526.4m represents growth of £21.7m (4%) on the previous year, a respectable achievement in the current competitive environment. Although balances have increased, the pressure on margins has constrained growth in net interest income to a modest 1% with non-interest income increasing by 10%.

Net interest income from the retail sector increased by £4.7m partially offset by lower wholesale net interest income. During the year the level of market risk was well within internal limits. Net interest income from wholesale activities was lower than last year due to a decline in investment yields. The net yield from the Bank's longer-term investment portfolio has declined as maturing, high yielding investments have had to be replaced with lower yielding assets in the current lower interest rate environment.

Net interest income from the Bank's retail sector increased, reflecting higher customer balances partly offset by a reduction in net interest margins. Average interest-earning assets increased by £1,158m (12%) reaching £10,762m. This growth was predominantly in the secured personal mortgage market, where average balances increased by £313m (11%), and corporate balances increased by £243m (13%). Wholesale market balances increased by £567m (21%). Average interest-bearing liabilities rose by £1,095m (14%) to £9,114m, principally due to growth in average interest-bearing retail customer deposits of £415m (8%) and an increase in wholesale deposits of £649m (30%).

The overall net interest margin declined during the year. This is partly a consequence of the strong growth achieved in mortgage lending and corporate lending relative to the stable level of the unsecured lending portfolio.

Average balances and interest margins

	2005 £m	2004 £m	Change £m
Net interest income	**320.5**	318.0	2.5
Average balances			
Interest-earning assets	**10,762**	9,604	1,158
Interest-bearing liabilities	**9,114**	8,019	1,095
Interest-free liabilities	**1,648**	1,585	63
Average rates	**%**	**%**	**%**
Gross Yield on interest-earning assets	**6.2%**	6.1%	0.1%
Cost of interest-earning liabilities	**3.8%**	3.4%	(0.4)%
Interest spread	**2.4%**	2.7%	(0.3)%
Contribution of interest-free liabilities	**0.6%**	0.6%	–
Net interest margin	**3.0%**	3.3%	(0.3)%

Secured quality mortgage lending and corporate syndicated and PFI lending represents a lower credit risk compared to unsecured personal lending and attracts a lower margin. Net interest margins on mortgages increased as balances have successfully been retained at higher margins at the end of offer periods but this was offset by decreasing margins for unsecured products, principally personal loans, in line with trends observed across the industry. In addition net interest margins on personal savings products have declined as new high interest products have been introduced. As a result of the combination of lower personal lending margins, new higher rate savings schemes, improvements in the asset mix and lower investment yields, the Bank's overall net interest margin reduced from 3.3% in 2004 to 3.0% for 2005.

During 2005 focus was placed on increasing less volatile non-interest income. Fees and commission receivable increased by £19.1m (11%) principally from growth in fee and commission generating current accounts (including Privilege, Privilege Premier and the **smile** fee-bearing account, **smile**more) and from LINK transaction fees from the Bank's extensive ATM network. Other sources of increased fee and commission income include the corporate sector, mortgages and higher VISA transaction levels.

Fees and commissions payable have declined by £1.5m mainly due to the strategy to concentrate sales effort towards existing customers. As a result the amount of commission paid to introducers has declined.

In 2005 there was a modest decline in insurance commission income reflecting higher income from the Bank's independent financial adviser subsidiary CBFA offset by lower third party insurance profits received from the insurance provider.

Non-interest income	**2005 £m**	**2004 £m**	**Change £m**
Fees and commission receivable	**193.9**	174.8	19.1
Insurance commission income	**45.6**	46.3	(0.7)
Fees and commission payable	**(39.1)**	(40.6)	1.5
Other income, including net trading income	**5.5**	6.2	(0.7)
Total	**205.9**	**186.7**	**19.2**

Operating costs

Operating costs increased by £9.1m (3%) to £328.8m. The Bank has continued to invest to improve and maintain systems and processes in a competitive market. However, this upward pressure on cost has been mitigated by tight cost control, and as a consequence the cost/income ratio has improved by 0.8 percentage points since last year.

Staff costs fell by £0.3m with higher salary costs due to the annual pay award offset by a reduction in staff numbers in the non-customer facing areas and by lower pension costs, reflecting the impact of the phased introduction of employee contributions during the year and a lower net pension finance charge.

Other operating costs were £9.4m higher than last year reflecting costs associated with the income generating ATM network and significant costs incurred on regulatory compliance, including Basel II and commitments to industry-wide initiatives including development of BACS payment systems. In addition, the Bank has incurred additional central investment and restructuring costs relating to the reorganisation of CFS and a strategic review of the banking business. The creation of CFS as a combined financial services provider across banking and insurance with a common management structure should provide future opportunities to realise operational efficiencies. However, in order to realise such benefits further investment in infrastructure and systems will, inevitably, be required.

Operating cost analysis	**2005 £m**	**2004 £m**	**Change £m**
Staff costs			
Wages and salaries	**101.9**	98.9	3.0
Pensions and social security costs	**29.2**	33.3	(4.1)
Other staff costs	**8.7**	7.9	0.8
	139.8	140.1	(0.3)
Other administrative expenses	**164.3**	156.9	7.4
Depreciation and amortisation	**24.7**	22.7	2.0
Total operating costs	**328.8**	**319.7**	**9.1**
Cost/income ratio	**62.5%**	63.3%	(0.8)%

Mortgage lending remained strong, achieving an 11% growth in average balances.

Credit quality and impairment losses

The benign personal credit climate of previous years declined markedly in 2005 with a significant increase in the number of customers with payment difficulties. Although the favourable economic conditions of low unemployment, low interest rates and low inflation continued during the year consumer indebtedness was at unprecedented levels, personal bankruptcies in the UK increased throughout the year and consumer confidence declined. In line with other lenders the Bank's impairment charge increased by £29.1m to a charge of £99.8m. Impairment losses as a percentage of year-end loans and advances to customers were 1.26%, an increase of 0.33 percentage points compared to 2004.

Strong credit quality in the corporate lending portfolio has offset higher impairment levels in the personal unsecured market. The corporate sector has suffered relatively low bad debt charges in recent years as the credit climate has remained benign. The Bank's strategy is to build a portfolio across a breadth of customers ranging from SMEs to syndicated lending, local authorities and PFI deals coupled with a controlled decline in exposure to higher risk sectors. Consequently, on an ongoing basis there are a limited number of problem accounts. The corporate impairment charge for 2005 has declined by £2.6m to £11.5m.

Personal sector impairment losses increased by £31.7m, a deterioration of 0.5% in the ratio to average retail lending. In common with many other lenders the most significant increase has arisen in the VISA portfolio, perhaps a reflection of the market where consumers are encouraged by many other providers to increase debt without properly assessing their repayment ability. Impairment losses within the mortgage book remain extremely low reflecting conservative lending policies and low loan to value ratios. The Bank remains a responsible lender and despite competitive pressure has not relaxed credit acceptance criteria nor compromised asset quality. On the contrary, credit policy has been tightened and the Bank has continued to enhance its ability to identify and manage over-indebtedness through the use of advanced scoring techniques. In order to improve lending decisions and to ensure responsible lending, the Bank also contributes full information on all lending products with the three main credit reference agencies and has recently announced the sharing of behavioural information on spending. Both of these activities will help to identify those customers who may be over-committed.

Impairment losses	**2005 £m**	**2004 £m**	**Change £m**
Income statement charge			
Personal sector	**88.3**	56.6	31.7
Corporate sector	**11.5**	14.1	(2.6)
Total	**99.8**	**70.7**	**29.1**
Charge as a percentage of loans and advances to customers	**1.26%**	0.93%	0.33%

Supervision and regulation

The Co-operative Bank p.l.c. is authorised by the Financial Services Authority (FSA) to carry out a range of regulated activities within the UK and is subject to consolidated CFS supervision. In its role as supervisor, the FSA is seeking to ensure the safety and soundness of financial institutions with the aim of strengthening, but not guaranteeing, the protection of customers.

The FSA's continuing supervision of authorised financial institutions is conducted through a variety of regulatory tools, including the collection of information from prudential returns, reports obtained from skilled persons, visits to firms and regular meetings with management to discuss issues such as performance, risk management and strategy.

The FSA assumed full responsibility for the regulation of the UK Mortgage and General Insurance markets from January 2005. Since its formation in late 2003, CFS Regulatory Compliance has continued to develop an increasingly regular and effective dialogue with the CFS group's supervision team at the FSA. This is in direct response to the FSA's increasing desire to focus on CFS group wide strategy and the various risks, challenges and opportunities the group faces.

Underpinning the FSA's key themes are its main strategic objectives of promoting efficient, orderly and fair markets and helping retail customers achieve a fair deal, principles which are shared and embedded into the CFS vision and business agenda. FSA research into fair treatment of customers continued during the year. A paper published in July set out the issues that firms should consider in their day-to-day dealings with customers. The challenge laid down by the FSA to embed the principle of Treating Customers Fairly (TCF) into the operations, systems and controls, and culture of firms has been embraced by the Bank. Whilst the customer is always at the heart of what we do, TCF is now firmly embedded in our language, our actions, and in our decision-making processes.

The Basel Committee on Banking Supervision and the European Commission have issued a revised framework for the allocation of regulatory capital for credit risk and to introduce a capital adequacy requirement for operational risk. The revised framework will seek to ensure that levels of capital held are commensurate with the risks associated with the business profile and control environment within financial institutions. The revised Basel Capital Accord and the EU Capital Requirements Directive are expected to be phased in from the start of 2007. A Basel II programme is well established within the Bank to develop risk management systems to provide improved control and business benefit, and ensure compliance with the forthcoming regulations.

Summary and outlook

During a period of intense competition, The Co-operative Bank was able to achieve progress in a number of areas. Profit before impairment charges increased by £12.6m (7%), the cost/income ratio improved, and robust capital ratios were maintained. However, the impairment charge deteriorated significantly, leading to a decline in profit before tax. The Bank operates in a highly competitive market. There are uncertainties in the banking sector, including pressures on bank charges, credit card fees and product suitability. However, the Bank maintains a balance of corporate and retail business, offers a diverse range of products with a focus on customer service and has taken action to mitigate the impact of any further downturn in the credit climate.

We have taken many important steps to ensure compliance with forthcoming risk management regulations.

Consolidated proforma income statement

For the year ended 14 January 2006
All amounts are stated in £m unless otherwise indicated

Impact of IAS32 and IAS39 on 2004

The Bank has applied IAS32 and IAS39 from 9 January 2005. Therefore, the effects of IAS32 and IAS39 are not shown in the statutory income statement for 2004. The 2004 analysis in the income statement below has been restated to include the effects of IAS32 and IAS39.

	2005	2004
Interest and similar income	**669.4**	593.3
Interest expense and similar charges	**(348.9)**	(275.3)
Net interest income	**320.5**	318.0
Fee and commission income	**239.8**	221.4
Fee and commission expense	**(39.1)**	(40.6)
Net fee and commission income	**200.7**	180.8
Dividend income	**0.3**	0.3
Net trading income	**4.9**	5.6
Operating income	**526.4**	504.7
Operating expenses	**(328.8)**	(319.7)
Profit before impairment losses	**197.6**	185.0
Impairment losses on loans and advances	**(99.8)**	(70.7)
Operating profit	**97.8**	114.3
Profit based payments to members of the Co-operative Group	**(1.3)**	–
Profit before taxation	**96.5**	114.3
Income tax expense	**(30.9)**	(36.0)
Profit for the period	**65.6**	78.3
Attributable to:		
Equity shareholders	**63.2**	76.2
Minority interests	**2.4**	2.1
	65.6	78.3
Earning per share (basic and fully diluted)	**5.75p**	6.93p

Executive Committee

David Anderson

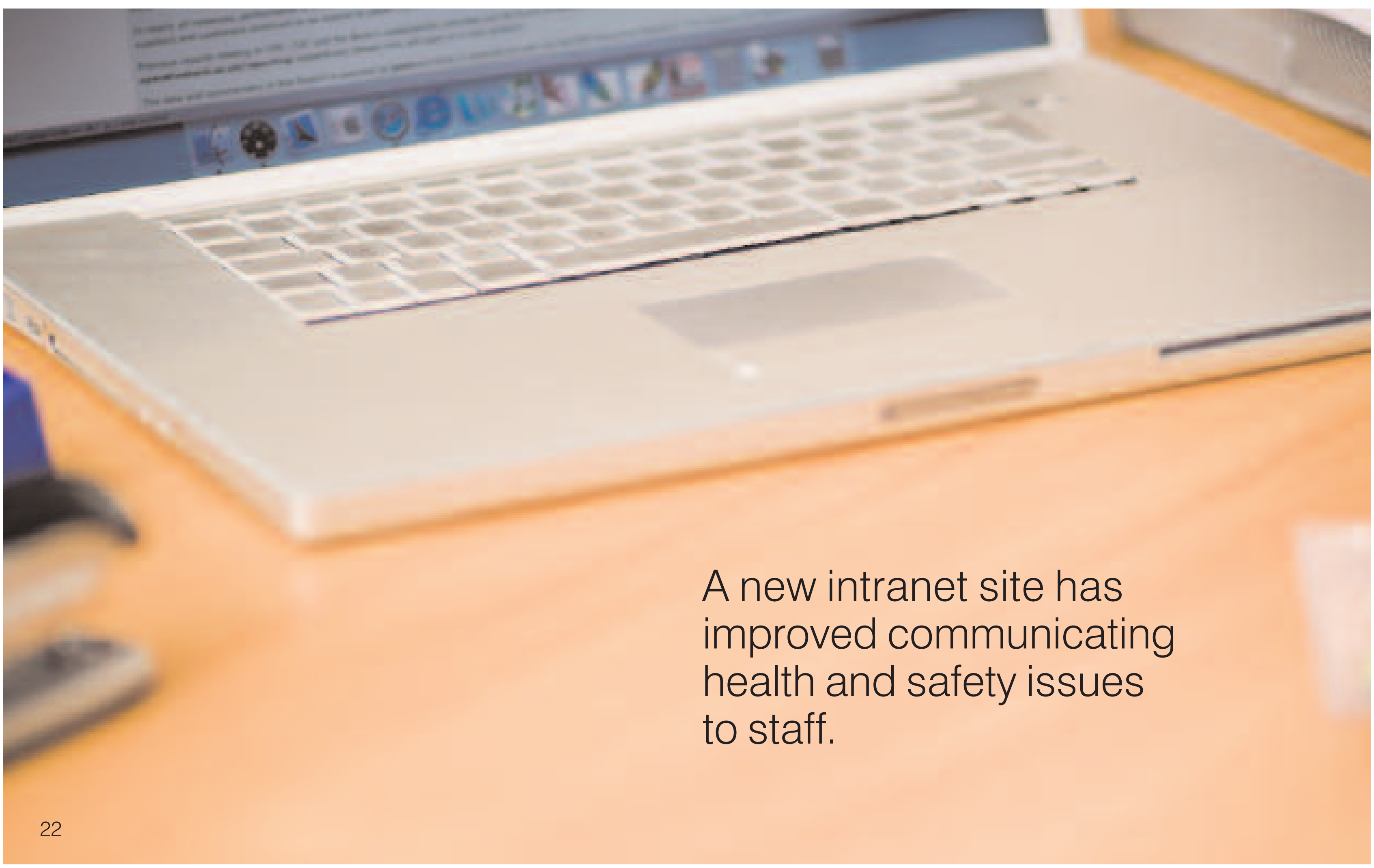
Stephan Pater

Mike Fairbairn

Craig Shannon

John Reizenstein

Gerry Pennell



A new intranet site has improved communicating health and safety issues to staff.

Corporate responsibility: safeguarding the business.

Introduction

CFS recognises the need to develop its business in a sustainable manner. CFS' Sustainability Report describes six groups, or Partners, upon whom its continued success is, to varying degrees, dependent. CFS has established a world-class reputation with regard to the management and reporting of the degree to which it delivers value to its Partners in an ecologically sustainable and socially responsible manner. In 2005, the CFS Sustainability Report 2003/04 was declared to be the best in the European Sustainability Reporting Awards.

Significant risks

The following ethical and sustainability issues have been identified as being most material to the business of Bank (i.e., those risks determined to be potentially material to the short and long term value of the business).

Employee practices and workplace safety

Key Performance Indicators connected with the CFS Strategic Plan now include a measure of staff satisfaction, which is derived from responses to an annual staff survey. For CFS' Executive Directors, remuneration will now be partly linked to performance targets in this area (and that of customer satisfaction). CFS' Sustainability Report details how satisfied staff are in the areas of most importance to them: these are salary package, personal development/career opportunities, working environment, job security and co-operative culture and ethical conduct.

The launch of a CFS Work/Life Balance policy and CFS Diversity and Dignity at Work policy has been delayed and will now be progressed in 2006.

CFS ensures that all reasonable steps are taken to:

- safeguard the health, safety and welfare of members of staff whilst they are at work;
- protect visitors and other non-employees, who may be affected by any potential hazard created by CFS premises or operations.

Formal consultation arrangements with Trades Unions exist through the Health and Safety Committee. A new health and safety intranet site has been established. This has assisted in communicating health and safety issues, and improved ease of access for staff to forms, guidance, policies and procedures.

An electronic accident reporting system was also introduced earlier in the year, and this has helped considerably in collating accident statistics. CFS' Sustainability Report provides further details of performance in this area.

Statutory and regulatory compliance/industry codes of conduct

Regulatory activity for this year has been focused on the implementation and effectiveness of the Financial Services Authority's regulation of the mortgage and general insurance market; and also upon ensuring processes and practices adhere to the revised Banking and Business Banking Codes introduced in March.

Since its formation in late 2003, CFS Regulatory Compliance has continued to develop an increasingly regular and effective dialogue with the CFS group's supervision team at the FSA. This is in direct response to the FSA's increasing desire to focus on CFS group wide strategy and the various risks, challenges and opportunities the group faces.

Principal activities this year have included managing the FSA group wide ARROW risk assessment visit and its findings, and supporting major CFS programmes, including the group's response to the FSA's Treating Customers Fairly initiative. In November 2005, CFS created a single Financial Crime Management Department to ensure that there is a full end-to-end response to fraud issues.

Internally, the Bank has monitored the effectiveness of the implementation of the new regulation/codes by undertaking post-implementation audits and compliance monitoring programmes. The Banking Code Standards Board have completed reviews of the Bank's activity throughout the year to assess compliance with the Banking Code and Business Banking Code.

The Bank complies with the rules governing anti-money laundering activities as set out in the FSA's Money Laundering Sourcebook. During 2005, further investments were made in a project to implement a new anti-money laundering solution that will systematically and intelligently monitor its customer accounts and daily transactions in order to further automate the detection of unusual behaviour.

Our customers views on the environment are directly reflected in our Ethical Policy.

Ethical policies implementation

Key Performance Indicators connected with the CFS Strategic Plan now include two measures of social responsibility: one based around unprompted awareness amongst the UK general public of the Bank and CIS as socially responsible financial institutions, and one based around the quality of CFS' management and reporting in the areas of ethics and sustainability. In 2005, 'Commitment to goals and values' formed part of the self-management themes of the CFS competency framework, with staff being encouraged to understand and act as advocates of the co-operative and ethical values that underpin CFS. In 2006, CFS was benchmarked against the world's largest one hundred companies and an Accountability Rating derived. This rating, which measures the degree to which businesses respond to stakeholder expectations in their corporate strategy, scored CFS at 87%. By comparison, the next best performer scored 78%.

The Co-operative Bank launched its Ethical Policy in 1992, and this was subsequently reviewed in 1995, 1998 and 2001. The Ethical Policy stipulates who the Bank will and will not finance, as directed by customers. Through 2005 this was supported by the CFS Sustainable Development Team. As of 2002, the Bank has provided a detailed annual breakdown of all instances where business has been declined, most recently in the CFS Sustainability Report. CFS' sustainability auditors, **just**assurance, directly investigate, on a sample basis, the veracity of policy implementation; reviewing case files and assuring themselves of the integrity of the process and outcome. Furthermore, Ethical Policy implementation is subject to an annual internal audit review.

During 2006, governance of Bank Ethical Policy development and implementation will be updated following the integration of CFS and Co-operative Group sustainability teams.

Key suppliers and outsourcing

Effective contract and relationship management is required for key suppliers and outsourcing in order to assure service provision and financial performance. CFS' Sustainability Report describes performance (together with benchmarking) in the areas of 'prompt payment', 'good relationships', 'fair treatment' and 'effective communication'.

It also details the operation of a CFS Outsourcing Policy and the contract areas falling under FSA guidance. The Outsourcing Policy outlines best practice for general outsourcing arrangements, but is considered mandatory for all material outsourcing arrangements (defined as those instances where a weakness or failure on the part of the service provider would reduce availability of a CFS critical service to below 50% for over four hours, or result in an unexpected cost in excess of £500k). A risk assessment is undertaken quarterly as part of a review of each outsourcing contract, and this is submitted to the respective Bank/CIS risk management committee.

As of 2004, CFS has operated a Sustainable Procurement and Supplier Policy. This was supported through 2005 by the CFS Sustainable Development Team and the CFS Sustainability Steering Committee. In parallel, a CFS-wide Supplier Acquisition and Management (SAM) Policy operates, which is designed to allow CFS to pool its supplier intelligence, maximise buying potential and to reduce risk by ensuring that business arrangements are documented to a consistent standard. Through 2005, the SAM Policy was supported by CFS Procurement and Supplier Management and a SAM Steering Group, and covered spend in excess of £50k and/or business critical goods and services. During 2006, policy and governance of supplier issues will be updated following the integration of CFS and Co-operative Group Procurement, Facilities and Sustainability teams.

Governance

The Bank can confirm the following:

The Board receives quarterly progress reports on ethical and sustainability matters, and the degree to which they impact on the business. In addition, the Board approves the CFS Sustainability Report, which describes the degree to which CFS delivers value in an ecologically sustainable and socially responsible manner. Unless otherwise stated, the Report is considered to be a complete commentary on CFS's material ethical and sustainability impacts. The Report also details some 60 targets; these in part seek to be responsive to stakeholders views on performance expectation.

The Board has identified and assessed the significant risks to the business arising from social, ethical and environmental matters via the risk management process described on page 55. CFS operates a central risk register containing some 500 risks and associated internal controls. CFS has established a Sustainable Development Policy, incorporating a rigorous system of stakeholder engagement, management and reporting, and this is consistent with the AA1000 management framework, as described in its Sustainability Report. The CFS Sustainability Report, and underlying accounting systems and management controls, is subject to rigorous third-party assurance as per AA1000as. CFS considers it vital that social, ethical and environmental issues are identified, on the basis that they are material to Partners' concerns, and not only on the basis of the degree to which they impact on the 'bottom line' of the business. To this end, the CFS Sustainability Report describes a much broader set of ethical and sustainability impacts than those assigned via the ABI guidelines.

Business continuity

Business continuity for The Co-operative Bank is managed by its parent organisation, CFS.

CFS' business continuity policy is aligned with the overall objectives and priorities of the business and aims to protect the interests of the Bank's customers, employees and other stakeholders by minimising the risk of disruption to critical business operations caused by unplanned events. A business continuity management team works with the Information Systems department and colleagues across the business to identify and protect critical premises, systems, processes and people through continuity and resilience measures, including the provision of back-up facilities by third parties.

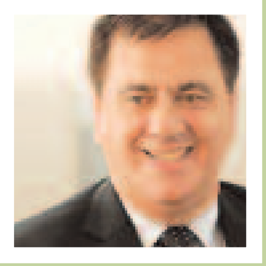
Each business unit is required to prepare, maintain and regularly update plans for the continuity/resumption of key functions in the event of operational disruption. Plans are regularly rehearsed and tested. Wider-ranging incident response and crisis management plans are also in place and have been tested.

During 2005, in addition to the internal testing programme, CFS was pleased to actively participate in the Tripartite Authorities (HM Treasury, the Bank of England and the Financial Services Authority) Market-Wide Exercise, the largest ever test of the preparedness of the UK financial sector to respond to a major crisis such as a terrorist attack, natural disaster or widespread infrastructure damage.

Each business unit is required to prepare, maintain and regularly update plans for continuity.

The Board: Executive Directors


David Anderson


Stephan Pater


John Reizenstein


Craig Shannon

The Board: Non-Executive Directors

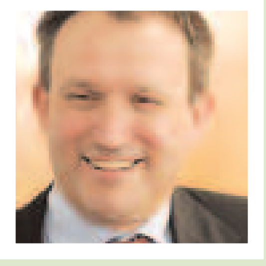

Graham Bennett


Martin Beaumont

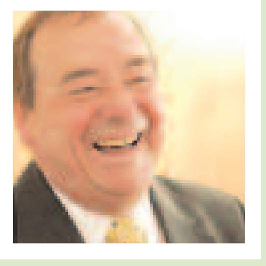

Bob Burlton

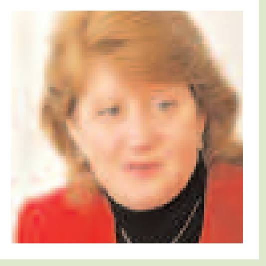

Simon Butler

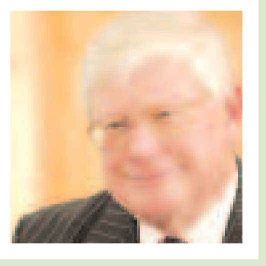

David Davies


Paul Hewitt


Tony Lancaster


Terry Morton


Kathryn Smith


Graham Stow


Len Wardle


Stephen Watts


Piers Williamson

The Co-operative Bank Board

Non-Executive Directors:

Graham Bennett Age 55. Chair of The Co-operative Bank plc. Occupation – Chief Executive Officer and Secretary, Southern Co-operatives. Non-Executive Director of the Co-operative Group, Co-operative Financial Services Limited and Co-operative Insurance Society Limited. First appointed to the Bank Board in 1989.

Martin Beaumont Age 56. Deputy Chair. Occupation – Chief Executive, the Co-operative Group. Non-Executive Director of Co-operative Financial Services Limited and Co-operative Insurance Society Limited. First appointed to the Bank Board in 1996.

Bob Burlton Age 57. Occupation – Chief Executive, The Midcounties Co-operative. Chair of the Co-operative Group and Co-operative Financial Services Limited. Non-Executive Director of Co-operative Insurance Society Limited. First appointed to the Bank Board in 2004.

Simon Butler Age 51. Occupation – Photographer. Member of the Co-operative Group Central & Eastern Regional Board. Chair of Co-operative Insurance Society Limited. Non-Executive Director of the Co-operative Group and Deputy Chair of Co-operative Financial Services Limited. First appointed to the Bank Board in 2003.

David Davies Age 58. Senior Independent Director. Occupation – Independent Professional Non-Executive Director. Also holds this position on the Boards of Co-operative Financial Services Limited and Co-operative Insurance Society Limited. He is Chairman of Sun Life Assurance Company of Canada (UK) Limited. First appointed to the Bank Board in 2003.

Paul Hewitt Age 50. Occupation – Deputy Chief Executive, the Co-operative Group. Acting Chief Executive of the Bank until June 2005. Non-Executive Director of Co-operative Financial Services Limited and Co-operative Insurance Society Limited. First appointed to the Bank Board in 2003.

Tony Lancaster Age 63. Occupation – Independent Professional Non-Executive Director. Also holds this position on the Boards of Co-operative Financial Services Limited and Co-operative Insurance Society Limited. Previously Chair and Chief Executive of Groupama Insurance Company. Holds various non-executive appointments on a variety of financial services organisations. First appointed to the Bank Board in 2004.

Terry Morton Age 60. Occupation – Managing Secretary for the Durham Alliance for Community Care. Deputy Chair of the Co-operative Group. Chair of the Co-operative Group North Eastern & Cumbrian Regional Board. Non-Executive Director of Co-operative Financial Services Limited and Co-operative Insurance Society Limited. Appointed to the Bank Board on 15 January 2006.

Kathryn Smith Age 46. Occupation – Public Relations Consultant. Member of the Co-operative Group South East Regional Board. Non-Executive Director of the Co-operative Group, Co-operative Financial Services Limited and Co-operative Insurance Society Limited. First appointed to the Bank Board in 2001.

Graham Stow Age 61. Occupation – Independent Professional Non-Executive Director. Also holds this position on the Boards of Co-operative Financial Services Limited and Co-operative Insurance Society Limited. Previously Group Chief Executive of Britannia Building Society from 1999 until 2003. First appointed to the Bank Board in 2003.

Len Wardle Age 61. Occupation – University Fellow. Member of the Co-operative Group South East Regional Board. Non-Executive Director of the Co-operative Group, Co-operative Financial Services Limited and Co-operative Insurance Society Limited. Appointed to the Bank Board on 15 January 2006.

Stephen Watts Age 54. Occupation – Business Studies Lecturer. Member of the Co-operative Group Central & Eastern Regional Board. Non-Executive Director of the Co-operative Group, Co-operative Financial Services Limited and Co-operative Insurance Society Limited. Appointed to the Bank Board on 15 January 2006.

Piers Williamson Age 44. Occupation – Chief Executive, The Housing Finance Corporation. Independent Professional Non-Executive Director. Also holds this position on the Boards of Co-operative Financial Services Limited and Co-operative Insurance Society Limited. First appointed to the Bank Board in 2005.

Executive Directors:

David Anderson Age 50. Chief Executive. Also Chief Executive of Co-operative Financial Services Limited and Co-operative Insurance Society Limited. Appointed on 1 June 2005.

Stephan Pater Age 54. Executive Director, CFS Distribution and Service. Also Executive Director of Co-operative Financial Services Limited and Co-operative Insurance Society Limited. First appointed to the Bank Board on 15 January 2006.

John Reizenstein Age 49. Chief Financial Officer. Also Executive Director of Co-operative Financial Services Limited and Co-operative Insurance Society Limited. First appointed to the Bank Board in 2004.

Craig Shannon Age 42. Executive Director, CFS Business Management. Also Executive Director of Co-operative Financial Services Limited and Co-operative Insurance Society Limited. First appointed to the Bank Board in 2004.

The Directors submit their report, together with the audited financial statements, for the year ended 14 January 2006.

Principal activities and business review

The Bank and its subsidiary undertakings provide an extensive range of banking and financial services in the United Kingdom.
A review of the performance of the Bank and its operating subsidiaries together with future developments are set out on pages 13 to 20 in the Operating and Financial Review section of this report. Note 32 of the financial statements provides details of the principal subsidiaries.

Outlets

At 14 January 2006 the Bank had 119 outlets.

Changes to the Board

The names of the present members of the Board and their biographies and details of length of service are set out on page 28.
David Anderson, Chief Executive was appointed on 1 June 2005 in place of Paul Hewitt, Acting Chief Executive. Paul Hewitt has remained on the Board as a Non-Executive Director in his capacity as Deputy Chief Executive, the Co-operative Group.
Sheila Macdonald (Chief Operating Officer), John Marper and Peter Sutcliffe retired from the Board on 14 January 2006. On the same day, Richard Goddard resigned from the Board to take up a position within CFS.
Piers Williamson was appointed as an Independent Professional Non-Executive Director on 1 July 2005. Terry Morton, Stephen Watts and Len Wardle were appointed as Non-Executive Directors on the Board with effect from 15 January 2006, and Stephan Pater was appointed as an Executive Director on the same day.

Election of Directors

In accordance with the Articles of Association, David Anderson, Piers Williamson, Terry Morton, Stephan Pater, Len Wardle and Stephen Watts having been appointed since the date of the last Annual General Meeting, retire and being eligible, offer themselves for re-appointment at the next Annual General Meeting.
In accordance with the Articles of Association, Simon Butler, Graham Stow, Martin Beaumont and Kathryn Smith retire by rotation and, being eligible, offer themselves for re-election. None of the Directors offering themselves for re-election have service contracts with the Bank or any of its subsidiary undertakings which has a duration of more than one year.
All Directors up for re-appointment and re-election continue to demonstrate commitment to their roles (see schedule of attendance on page 34).
The Notice for the Annual General Meeting at which the re-election of Directors will be proposed can be found on page 88.

Results and dividends

The profit before taxation was **£96.5 million** (2004 – £126.6 million), a decrease of £30.1 million on 2004. The profit attributable to the ordinary shareholders amounted to **£63.2 million**. Interim dividends of £5 million and £13.75 million were paid on 31 May 2005 and 30 September 2005 respectively. The Directors do not recommend the payment of a final dividend.
A more detailed review of the business is contained in the Operating and Financial Review on pages 13 to 20.
The Bank is part of the Co-operative Group and in 2005 the Society returned over £6.2 million of profits to members. This was distributed in proportion to the value of trade each member undertook with the Society.

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.
The Directors' interests in the Bank's 9.25% £1 preference shares were as follows:

	Number of Shares	
	2005	**2004**
John Marper	11,042	11,042

No other Director had a beneficial interest in any shares in the group or in the Co-operative Group which is the ultimate holding organisation, or in any other entity controlled by the Co-operative Group.
There have been no changes in the Directors' shareholdings between the end of the financial year and 6 April 2006.

Staff

The Bank and its subsidiary undertakings employed **4,271** persons at 14 January 2006 (2004 – 4,300). The weekly average number of persons was **4,274** (2004 – 4,356) and their aggregate remuneration for the year was **£101.9 million** (2004 – £98.9 million).
The Bank operates learning and development initiatives across the organisation as part of a continuous improvement programme, supporting its approach to performance management, personal development, talent and succession planning.
The Bank continues to consult and communicate with staff on customer, organisation and business performance issues, using staff publications, surveys, conferences, videos, and forums with Amicus-UNIFI, who continue to be fully involved with the Bank where organisational change and other issues affect staff, through the Partnership Agreement. The Bank has been acknowledged as an "Investor in People" company in the UK.

Diversity

The Bank welcomes diversity and actively promotes a policy and practice of equality of opportunity in employment for all employees, regardless of sex, gender reassignment, marital status, sexual orientation, colour, race and nationality, national or ethnic origin, religion or creed, disability, responsibility for dependants, age, membership or non membership of a trade union or political affiliation.

Employees with disabilities

The Bank is a member of the Employers' Forum on Disability, which provides advice and guidance on the employment of people with disabilities. The Bank is a holder of the "Positive about Disabled People" symbol, a recognition given by Jobcentre Plus to employers who have agreed to meet five commitments regarding the recruitment, employment, retention and career development of disabled people. The Bank has an Equal Opportunities Policy, which includes provisions to consider employment applications from people with disabilities and to match vacancies with an individual's particular aptitudes and abilities. Additionally, it has produced bespoke Disability Discrimination Act guidance for staff, which outlines its responsibilities with respect to the employment of people with disabilities. Further guidance and information for staff on disability issues is available through Human Resources and on the staff intranet. The Bank recognises its responsibility for making "reasonable adjustments" for new staff with disabilities and for those individuals who develop disabilities whilst in employment.

Corporate responsibility and the environment

The Bank's corporate responsibility activities are outlined on pages 23 to 26. In addition, the CFS Sustainability Report, which will be published towards the latter half of the 2006 financial year, describes how CFS, CIS and the Bank manage their social, ethical and environmental impacts.

Political and charitable donations

During the year, the Bank and its subsidiaries made donations (which excludes affinity card payments) of **£0.7 million** (2004 – £0.6 million) to United Kingdom charitable organisations. Additional costs associated with the Bank's community involvement are provided within the CFS Sustainability Report. It is the Bank's policy that no donations are made for political purposes.

Market value of land and buildings

Freehold and leasehold land and buildings held by the Bank are held on the balance sheet at historic cost and have not been revalued.

Supplier payment policy and practice

The Bank's suppliers are one of six groups it recognises as partners in its business, each of whom has clear responsibilities to the Bank, which in turn acknowledges its responsibilities to them. The Bank considers that the prompt payment of invoices is one of its responsibilities to its suppliers and is a signatory to the Better Payment Practice Code. Signatories to the code promise to agree payment terms at the outset of a relationship, explain their payment procedures to suppliers, pay bills in accordance with any contract agreed with the supplier, or as required by law, tell suppliers without delay when an invoice is contested and settle disputes quickly. Bank policy on supplier payment is compliant with the provisions of the Late Payment Act, 2002. The Bank had **17** days (2004 – 16 days) purchases outstanding at 14 January 2006, based on the average daily amount invoiced by suppliers during the financial year.

Statement of Directors' responsibilities in respect of the Directors' report and the financial statements

The Directors are responsible for preparing the Directors' Report and the financial statements in accordance with applicable law and regulations.

Company law requires the Directors to prepare financial statements for each financial year. Under that law they have elected to prepare the financial statements in accordance with IFRSs as adopted by the EU.

The financial statements are required by law to present fairly the financial position and the performance of the Company and the group; the Companies Act 1985 provides in relation to such financial statements that references in the relevant part of that Act to financial statements giving a true and fair view are references to their achieving a fair presentation.

In preparing these financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether they have been prepared in accordance with IFRSs as adopted by the EU; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Company and the group will continue in business.

Under applicable law, the Directors are also responsible for preparing a Directors Report and a Corporate Governance Statement, that comply with the law and those regulations.

The Directors are responsible for keeping proper accounting records that disclose with reasonable accuracy at any time the financial position of the Company and the group and enable them to ensure that their financial statements comply with the Companies Act 1985. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Company and the group and to prevent and detect fraud and other irregularities.

Auditor

In accordance with Section 385 of the Companies Act 1985, a resolution for the re-appointment of KPMG Audit Plc as auditor of the Bank and a resolution to authorise the Directors to fix their remuneration are to be proposed at the next Annual General Meeting.

By Order of the Board
Moira Lees, Secretary
6 April 2006

UK Combined Code on Corporate Governance

The Bank seeks to comply with the Combined Code. A review is also underway to look at the findings of the Flint review of 'Internal Control: Guidance for Directors on the Combined Code', issued by the Financial Reporting Council in October 2005.

Responsibility of The Co-operative Bank Board

The Directors are committed to leading and controlling the Company effectively. The Board is responsible for the success of the Company within a framework of controls, which enables risk to be assessed and managed. It is responsible for setting strategy, maintaining the policy and decision making framework in which this strategy is implemented, ensuring that the necessary financial and human resources are in place to meet strategic aims, monitoring performance against key financial and non-financial indicators, overseeing the system of risk management and for setting values and standards in governance matters.

The responsibility of the Bank Board is to direct the business of the Bank, and in particular to:

- ensure that the Company's affairs are conducted and managed in accordance with its Memorandum and Articles of Association, and in accordance with the best interests of its stakeholders within the ethics and values of co-operative principles;
- agree objectives, policies and strategies, and monitor executive management;
- determine the vision and strategy of the Company in consultation with the Chief Executive and the Executive;
- approve the annual budget and business plan;
- approve the reported financial statements and dividends;
- monitor, through various Committees, the key significant risks facing the Company;
- establish Board Committees; and
- approve the delegated financial authorities.

The Board manages these matters at its regular Board meetings and strategy meetings. It has met 10 times in 2005 and, in addition, has held strategy review meetings in June and December. The Board is scheduled to meet for 11 Board meetings and two strategy meetings in 2006.

Board balance and independence

The Board comprises thirteen Non-Executive Directors and four Executive Directors.
Paul Hewitt, previously Acting Chief Executive, was appointed Deputy Chief Executive of the Co-operative Group on 1 June 2005, and in this capacity he is a Non-Executive Director on the Bank Board.

The Board has appointed four Independent Professional Non-Executive Directors as defined under the Combined Code: David Davies, Tony Lancaster, Piers Williamson (appointed 1 July 2005) and Graham Stow. On 23 February 2005 the Bank Board appointed David Davies as the Senior Independent Director.

The code requires at least half of the Board, excluding the Chair, to be independent non-executive directors. In accordance with the Code, it is for the Board to consider 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 Board has concluded that looking across the wider Co-operative Group, Co-operative Group Regional Directors (unless employees within the last five years) should be defined as independent while those representing corporate members of the Co-operative Group could not be so categorised in the Co-operative context. This was because the latter represented significant "shareholders" with material business relationships.

With the exception of Graham Bennett and Bob Burlton, who represent corporate members of the Co-operative Group, and Martin Beaumont and Paul Hewitt, who hold executive appointments in the Co-operative Group, the Board have determined the remaining five Non-Executive Directors: Simon Butler, Terry Morton, Kathryn Smith, Len Wardle and Stephen Watts as regional directors of the Group to be independent. Together with the Independent Professional Non-Executive Directors, the balance of the Board meets with the Code's requirements. The Board believes that all the Non-Executive Directors have considerable experience and make valuable contributions to the operation of the Bank.

The Non-Executive Directors constructively challenge and help develop proposals on strategy, bring strong, independent judgment, knowledge, and experience to the Board's deliberations. The Non-Executive Directors are of sufficient calibre and number that their views carry significant weight in the Board's decision making.

The composition of the Boards of CFS, CIS and the Bank have been re-organised so that there is common membership of each.

Board procedures

Board and Committee papers are distributed at least one week in advance of meetings. This provides the opportunity for Directors to fully prepare for meetings. The minutes of all meetings are circulated to all Directors.

There is regular communication between the Directors, the Chair and the Secretary between meetings.

When a Director is unable to attend Board or Committee meetings, issues can be relayed in advance to the relevant Chair. Written questions for management on papers are encouraged from Directors between meetings. A rolling schedule of matters arising from Board and Committee meetings is followed through.

The Roles of the Chair and Chief Executive

The division of responsibilities between the Chair of the Board and the Chief Executive is clearly defined and has been approved by the Bank Board.

The Chair is a Non-Executive Director. He leads the Board in the determination of its strategy and in the achievement of its objectives. The Chair is responsible for organising the business of the Board, ensuring its effectiveness and setting its agenda. He has no involvement in the day-to-day business of the Bank. The Chair facilitates the effective contribution of Directors and constructive relations between the Executive and Non-Executive Directors, ensures Directors receive accurate, timely and clear information and facilitates effective communication with shareholders.

Details of the Chair's professional commitments are included in the Chair's biography on page 28. The Board is satisfied that these responsibilities do not interfere with the performance of the Chair's duties for the Company.

The Chief Executive 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.

Board Committees

With the agreement of the Financial Services Authority (FSA), the Board has delegated certain responsibilities to the following Committees, all of which have written terms of reference covering the authority delegated to it by the Board, copies of which are available from the Secretary on request.

Each of these Committees has a role in overseeing the Company and its subsidiaries.

Audit and Risk Committee

The Bank Board has delegated responsibility to the CFS Audit and Risk Committee.

The CFS Audit and Risk Committee comprises six members and, during the year was chaired by one of the Independent Professional Non-Executive Directors, Graham Stow. The Committee also comprised Terry Morton, Kathryn Smith, David Davies (resigned 1 July 2005), Tony Lancaster, Piers Williamson (appointed 1 July 2005) and Len Wardle. There were four meetings of the Committee during the financial year.

The former Executive Director, Finance and Actuarial of CFS, the former Executive Director Risk & Compliance of CFS, Heads of Internal Audit and the External Auditor usually attended by invitation.

The Code requires that at least one member of the CFS Audit and Risk Committee to have significant, recent and relevant financial experience, for example an auditor or finance director of a listed company. Whilst the Board has determined that no single member meets the requirements of the Code fully in respect of significant recent and relevant financial experience, it does believe, however, that collectively the Committee has the skills and experience required to discharge its duties in regard to the Bank.

Under its terms of reference, the Committee:

- monitors the integrity of the Bank's financial statements and any formal announcements relating to the Bank's performance, together with any significant financial reporting judgements contained in the financial statements;
- monitors the effectiveness of the external audit process and makes recommendations to the Board in relation to the appointment, re-appointment and remuneration of the external auditor;
- ensures that an appropriate relationship between the Company and the external auditor is maintained, including reviewing non-audit services and fees;
- reviews annually the Bank's systems of internal control and the processes for monitoring and evaluating the risks facing the Bank;
- reviews the effectiveness of the internal audit function and is responsible for approving, upon the recommendation of the Chief Executive, the appointment and termination of the Head of that function;
- reviews its terms of reference;
- reviews effectiveness annually and recommends to the Board any changes required as a result of the review; and
- ensures it complies with best practice and the combined code by agreeing a schedule of meetings and agenda items for the year ahead.

In 2005 the Committee discharged its responsibilities by reviewing:

- the Bank's draft financial statements and interim results statement prior to Board approval and reviewing the external auditor's detailed reports thereon;
- the appropriateness of the Bank's accounting policies;
- regularly the potential impact in the Bank's financial statements of certain matters and proposed International Financial Reporting Standards;
- the audit fee and reviewing non-audit fees payable to the Bank's external auditor;
- the external auditor's plan for the audit of the Bank's financial statements, which included key areas of work, key risks in the financial statements, confirmations of auditor independence, and approval of the terms of engagement for the audit;
- an annual report on the Bank's systems of internal control and its effectiveness, reporting to the Board on the results of the review and receiving regular updates on key risk areas of financial control;
- the risks associated with major business programmes; and
- the internal audit function's terms of reference, its work programme and reports on its work during the year.

The Committee also monitors the Bank's whistleblowing procedures, ensuring that appropriate arrangements are in place for employees to be able to raise matters of possible impropriety in confidence, with suitable subsequent follow-up action.

During the year, the Committee has reviewed its own effectiveness and is scheduled to be reviewed by the Group Board in the early part of 2006.

Members of the CFS Audit and Risk Committee have met KPMG the external auditor four times during 2005 and the Committee Chair met with Internal Audit four times in 2005, without the presence of management.

Remuneration & Appointments Committee

The CFS Remuneration & Appointments Committee meets as a joint committee for CFS, CIS and the Bank. The Committee currently comprises seven members and is chaired by the CFS Chair, Bob Burlton. During the year the Committee also comprised Martin Beaumont, Graham Bennett, Simon Butler, Terry Morton, Kathryn Smith and Graham Stow.

The Committee's role in respect of the Executive management and Executive Directors is to determine remuneration and employment policy, oversee contractual arrangements, review salaries, approve incentive schemes and any payments made under such schemes and recommend appointments to the Board. Non-Executive Directors are remunerated directly from the Bank's ultimate parent organisation – the Co-operative Group. The Committee also makes recommendations on appointments to Board Committees.

The Committee is supported by the Co-operative Group Remuneration & Appointments Committee in ensuring consistency, where appropriate, across the wider group. The Committee is responsible for overseeing succession planning. It uses external consultants for the appointment of the Executive and Independent Professional Non-Executive Directors. The Committee met seven times during 2005 and its report can be found on pages 38 to 42.

Bank Advances Committee

This Committee comprises seven members and is chaired by the Bank Chair, Graham Bennett. During the year the Committee comprised David Davies, Paul Hewitt, John Marper (former Executive Director Risk & Compliance, CFS), Kathryn Smith, and Kevin Blake (Credit Risk & Compliance Management Director during the year). David Anderson was appointed to the Committee on 1 June 2005 and Piers Williamson was appointed to the Committee on 1 July 2005. Keith Alderson (Director of Corporate Banking) usually attended the meetings by invitation.

The Committee met ten times during the financial year. The main responsibilities of the Committee are to:

- approve all advances in excess of the delegated lending authority of the Chief Executive;
- review all decisions taken within the delegated authority of the Chief Executive by way of Noting Returns;
- approve Policy, Sector and other Credit Strategy papers recommended by Credit Committee, and call for such papers and other reports as considered appropriate;
- review and approve the reports scheduled under the Credit Risk Management Policy Statement;
- note positions of reportable excesses for exposures that exceed the delegated lending discretions of the Chief Executive;
- note exposures equal to or greater than 5% of the Large Exposure Capital Base in line with revised reporting requirements introduced by the FSA in 2004;
- note individual counterparty positions on the High Risk Exposures Return, where the Credit Committee determines that these should be escalated; and
- review any other positions, which the Credit Committee determines should be brought to its attention.

Board Standing Committee

For consideration of urgent business between meetings, a Committee can stand. The Committee meets on an ad hoc basis. The Committee held one meeting in 2005. The Committee comprises the Chair, the Chief Executive, together with four Non-Executive Directors including the Senior Independent Director.

The following table sets out the frequency of, and attendance at, the Board and principal Committee meetings for the period under review by Directors at the financial year end.

	Main Board	CFS/Bank Audit and Risk Committee	CFS Remuneration and Appointments Committee	Bank Advances Committee	Board Standing Committee
Number of meetings held	10	4	7	10	1
Graham Bennett*	10 (10)	–	7 (7)	10 (10)	1 (1)
David Anderson	6 (6)	–	–	6 (6)	1 (1)
Martin Beaumont	9 (10)	–	6 (7)	–	1 (1)
Bob Burlton	10 (10)	–	7 (7)	–	1 (1)
Simon Butler	10 (10)	–	7 (7)	–	1 (1)
David Davies	9 (10)	1 (2)	–	4 (5)	1 (1)
Richard Goddard	10 (10)	–	–	–	–
Paul Hewitt	10 (10)	–	–	10 (10)	–
Tony Lancaster	9 (10)	4 (4)	–	–	–
Sheila Macdonald	10 (10)	–	–	–	–
John Marper	10 (10)	–	–	10 (10)	–
John Reizenstein	10 (10)	–	–	–	–
Craig Shannon	10 (10)	–	–	–	–
Kathryn Smith	10 (10)	2 (4)	6 (7)	10 (10)	–
Graham Stow*	10 (10)	4 (4)	6 (7)	–	–
Peter Sutcliffe	10 (10)	–	–	–	–
Piers Williamson	5 (5)	2 (2)	–	5 (5)	–

* Also members of the Co-operative Group Audit & Risk Committee.

The number in brackets indicates the total number of meetings the Director was eligible to attend during the year.

In the case of a Director being unable to attend a meeting, the Chair has received a satisfactory reason for their absence.

Attendance of CIS Directors who also sit on any of the above Committees may be found in the Statement of Corporate Governance in the 2005 Report and Financial Statements of that Society.

Provision of advice to Directors

A number of external consultants provide professional advice to the Boards of the constituent parts of the wider Co-operative Group. There is an agreed procedure by which directors may take independent professional advice at the Bank's expense in furtherance of their duties.

Directors and Officer's Indemnity Insurance

The Bank maintains appropriate Directors and Officers' Liability Insurance cover, through the ultimate parent organisation, in respect of legal action against its Directors. The arrangements for this were reviewed during the year.

Professional development

On appointment, Directors undertake an induction programme, designed to develop their knowledge and understanding of the Group. The induction is appropriately tailored to their experience and background and includes an overview of the Bank and the wider Group, together with the role of the Board and the matters reserved for its decision. Directors also receive information on the principal Board and management committees, and the powers delegated to those committees, the Bank's corporate governance practices and procedures, including the powers reserved to Executive members, and the latest financial information. Briefing sessions on the strategy and performance of the Bank's core business areas are also held with key members of the Executive.

A Board training programme exists which ensures that directors are regularly updated on the Bank's business, the competitive and regulatory environments in which it operates, corporate social responsibility matters and other changes affecting the Bank and the wider Group and the industries in which it operates.

Performance evaluation

In 2005, the Board, together with the Boards of CFS and CIS, undertook an away day which was externally facilitated. The objective was to explore the effectiveness of the Board, its dynamics and the relationship between the Executive and Non-Executive Directors. In addition, a thorough review of Board agendas was undertaken, resulting in significant changes as to how information is presented to the Board. It is the Board's view that these measures have further improved the Board's ability to discharge its responsibilities.

The Secretary to the Board

The Secretary is professionally qualified and is responsible for advising the Board through the Chair on all governance matters. The Directors have access to the advice and services of the Secretary. The Bank's Articles of Association and the schedule of matters reserved to the Board for decision provide that the appointment and removal of the Secretary is a matter for the full Board.

The Executive

It is the responsibility of the Executive Management to implement the strategic objectives as agreed by the Board. The Executive, under the leadership of the Chief Executive is responsible for the day-to-day management of the Bank.

From 15 January 2006, the Executive Management of the Boards of CFS, CIS and The Co-operative Bank have been re-organised under a single Executive Management framework.

Relations with shareholders

The Bank has two equity shareholders. The majority of shares are held by Co-operative Financial Services Limited, which is a wholly owned subsidiary of the Co-operative Group. The remainder of the shares are held by the Co-operative Group. With effect from 15 January 2006, all the Directors of the CFS Board were appointed to the Bank Board ensuring a common understanding of objectives.

The Bank has approximately 2,500 preference shareholders. The preference shares are fixed interest shares and are non-cumulative and irredeemable. The preference shareholders are entitled to attend the Annual General Meeting but the shares only carry speaking or voting rights if and when the dividend has been in arrears for six months or more, or if a resolution is to be proposed at the Annual General Meeting abrogating or varying any of their respective rights or privileges or for the winding-up of the Bank or other return of capital and then only on such resolution.

INTERNAL CONTROL

The Board has overall responsibility for the Company's system of internal controls, which aim to safeguard the Company's assets, ensure that proper accounting records are maintained and that the financial information used within the business and for publication is accurate, reliable and fairly presents the financial position of the Bank and the results of its business operations. The Board is also responsible for reviewing the effectiveness of the system of internal controls. This has been in place for the year under review and is regularly reviewed by the Board. The system is designed to provide reasonable assurance of effective operations and compliance with laws and regulations, although any system of internal controls can only provide reasonable, not absolute, assurance against material misstatement or loss, and can only mitigate rather than eliminate the risk of failure to achieve business objectives.

Since the publication in September 1999 by the Institute of Chartered Accountants in England and Wales of the Turnbull Report, 'Internal Control: Guidance for Directors on the Combined Code', the Directors have continued to review the effectiveness of the Bank's system of financial and non-financial controls, including operational and compliance controls, risk management and the Bank's high level internal control arrangements.

The Bank has adopted an internal control framework that contains the following key elements:

Control environment

The Bank's control environment is designed to create an attitude of taking acceptable business risk within clearly defined limits. The control environment includes:

- an organisational structure with clear lines of responsibility, delegation of authority and reporting requirements;
- clearly defined policies for capital and revenue expenditure. Larger capital and revenue expenditure requires Board authorisation;
- comprehensive systems of financial reporting. The annual budget and long term plan of the Bank and of each Division are reviewed and approved by the Board. Results are reported against budget and prior year. The relevant executives consider any significant changes and variances and remedial action is taken where appropriate;
- a Whistleblowing Policy and Procedure which provides for any employee to report in confidence, suspected serious malpractice;
- internal Audit and Compliance functions that review the system of internal control; and
- an Internal Controls Database. Business Managers undertake quarterly assessment of internal controls which mitigate their financial and non-financial risks.

Risk assessment
The Board and Executive management have the primary responsibility for identifying the key business risks facing the Company. The Board has established Board Committees and Executive Management Committees to administer a risk management process, which identifies the key risks facing the business and reviews reports submitted to those Committees on how those risks are being managed.

Management has the prime responsibility for identifying and evaluating significant risks and for designing and operating suitable controls.

Risks are documented in a Risk Register. Each risk is assigned to an appropriate manager who is responsible for ensuring that it is managed in accordance with the Bank's risk management process which is kept under review to ensure that it accords with best practice and the evolving requirements of the FSA. Risk assessments are updated on a quarterly basis. Significant risks are reported to the Risk Management Committee, the Executive Risk Review Committee and the CFS Audit & Risk Committee.

Details of the Bank's Risk Management policy and procedures are provided on pages 55 to 63.

Control procedures
The Bank control procedures are designed to ensure complete and accurate accounting for financial transactions and to limit the potential exposure to loss of assets or fraud.

Up to date manuals are maintained that cover the Bank's accounting policies and procedures, banking, insurance, employees' policies and procedures, and information technology standards. These manuals are issued to appropriate management who are trained in the procedures.

Information and communication
Communication takes place with all key stakeholders through a variety of media including the CFS Sustainability Report. Employees receive and provide information on strategy and objectives through their reporting lines and a formal performance measurement process. Newsletters, bulletins and electronic media communicate other information.

Monitoring
The operation of the system of internal control is the responsibility of line management. It is subject to independent review by Internal Audit and, where appropriate, by the Bank's external auditors and external regulators.

The CFS Audit and Risk Committee, on behalf of the Board, reviews the reports of the Bank on internal control. Full details of the operation of the Committee can be found on pages 32 to 33.

A key part of the work of the Committee is an annual 'letter of assurance' process by which responsible managers confirm the adequacy of their systems of internal financial and non-financial controls, their compliance with Bank policies (including those relating to safety, health and the environment), local laws and regulations (including the industry's regulatory requirements) and report any control improvements required. The Directors review the system of internal controls and believe it complies with the Turnbull Report guidance.

External Audit
One of the duties of the CFS Audit and Risk Committee is to make recommendations to the Co-operative Group Audit and Risk Committee in relation to the appointment of the external auditor. In 2003 the Co-operative Group Board approved the re-appointment of KPMG Audit Plc as the external auditor of the Co-operative Group and its subsidiaries, following a competitive tender exercise.

Details of the amounts paid to the external auditor during the year for audit and other services are set out in the notes on page 66.

The Committee has put in place safeguards to ensure that the independence of the audit is not compromised including a policy on the conduct of non-audit services from the external auditor. The external auditor is permitted to provide some non-audit services that are not, and are not perceived to be, in conflict with their independence. The Group Audit and Risk Committee receives at each meeting a report providing details of assignments and related fees carried out by the external auditors of the Bank in addition to their statutory audit work. The pre-approval of the Committee is required for services above certain thresholds determined by the Committee. In addition, the following assignments are prohibited from being performed by the external auditor:

- bookkeeping or other services related to the accounting records or financial statements;
- financial information systems design and implementation;
- actuarial services;
- internal audit outsourcing services;
- management functions or human resources; and
- any other services that the Audit and Risk Committee may determine.

The performance of the external auditor is regularly monitored to ensure it meets the needs of the Bank and the results are reported to the Committee.

Internal Audit

The Internal Audit Function is an independent appraisal function, which derives its authority from the Board through the CFS Audit and Risk Committee. Its primary role is to provide reasonable and objective assurance about the adequacy and effectiveness of the Bank's financial control framework and risk management.

Internal Audit seeks to discharge the responsibilities set down in its charter by reviewing the processes which ensure that business risks are effectively managed; reviewing the financial and operational controls which help to ensure that the Bank's assets are properly safeguarded from losses, including fraud; reviewing the controls which help to ensure compliance with corporate objectives, policies and procedures and external legislation and regulation; and on an ad hoc basis, reviewing that value for money is obtained.

Internal Audit also acts as a source of constructive advice and best practice, assisting senior management with its responsibility to improve the processes by which business risks are identified and managed and to report and advise on the proper and effective use of resources.

Internal Audit reports are submitted to the CFS Audit and Risk Committee and significant issues are reported from that Committee to the Co-operative Group Audit and Risk Committee.

STATEMENT ON GOING CONCERN

After making all appropriate enquiries, the Directors have a reasonable expectation that the Bank has adequate resources to continue in operational existence for the foreseeable future. For this reason, they continue to adopt the going concern basis in preparing the Bank's financial statements.

Remuneration report

The Co-operative Bank uses, as a guideline for its disclosure in relation to remuneration, the requirements applicable to Listed Companies, as set out in the Directors' Remuneration Report Regulations 2002 (incorporated into the Companies Act 1985).

The Bank Board comprises Non-Executive Directors including Independent Professional Non-Executive Directors appointed by the Co-operative Group Board, and Executive Directors appointed by the CFS Board. Paul Hewitt joined the Bank Board on 16 May 2003 as a Non-Executive Director and, on 16 December 2004, was appointed Acting Chief Executive for CFS, CIS and the Bank and acted in this capacity until the appointment of David Anderson on 1 June 2005. His emoluments in respect of his former role can be found in the Co-operative Group accounts, and those for the latter can be found in Table 1.

This report provides details of the remuneration of both the Executive Directors and Non-Executive Directors.

This report will be put to a vote of shareholders of the company at its Annual General Meeting which will be held on 10 May 2006.

Introduction

The Remuneration Report is presented by the Board and contains the following information:-

- a description of the role of the CFS Remuneration and Appointments Committee (the "Committee"), in respect of the Bank;
- a summary of the Bank's remuneration policy, including a statement of policy on Executive Directors and Non-Executive Directors; and
- details of the terms of the Service Contracts and the remuneration of the Executive Directors and Non-Executive Directors for the 2005 financial year.

The CFS Remuneration & Appointments Committee meets as a combined Committee for CFS, CIS and the Bank. Its role is described below.

Role of the Remuneration & Appointments Committee

The Committee's principal terms of reference are to:

- determine policy on remuneration and other main terms and conditions of employment;
- oversee contractual arrangements for Executive Directors and approve the principal terms and conditions of employment of such Executive Directors;
- review salaries using comparisons against the agreed market policy;
- approve any incentive schemes, and ensure that they are in line with current market practice, and authorise payments under any incentive schemes in line with their rules; and
- receive, review and decide on issues raised by the trustees of The Co-operative Bank Pension Scheme, and advise the Board about them as appropriate.

The Co-operative Group Remuneration & Appointments Committee oversees these arrangements in respect of the Chief Executive.

The Committee comprises seven members and is chaired by the CFS Chair, Bob Burlton. During the year members of the Committee were: Martin Beaumont, Graham Bennett, Simon Butler, Terry Morton, Kathryn Smith and Graham Stow. The Committee's role in respect of Executive Management is to determine remuneration and employment policy, oversee contractual arrangements, review salaries, approve incentive schemes and any payments made under such schemes and recommend appointments of the Board. In respect of Directors, the Committee makes recommendations to members in a General Meeting for decision. The Committee is supported by the Co-operative Group Remuneration & Appointments Committee in ensuring consistency, where appropriate, across the wider group. The Committee is responsible for overseeing succession planning.

The Committee members are all Non-Executive Directors, one of whom is an Independent Professional Non-Executive Director. They have no personal financial interests in the Committee's decisions, and they have no involvement in the day-to-day business of the Bank. The Committee met seven times in the period under review.

To ensure that it receives independent guidance on remuneration matters, the Committee has retained remuneration consultants Watson Wyatt as its advisers. Watson Wyatt has supplied advice on remuneration survey data, market trends and pensions matters, including incentive schemes. Watson Wyatt also provides specialist advice in relation to The Co-operative Bank Pension Scheme and some other general remuneration advisory services. Solicitors Addleshaw Goddard, who were appointed by the Secretary of the Committee, provided legal advice to the Committee with respect to Executive Directors' service contracts.

Policy on Directors' remuneration

Executive Directors

In determining the remuneration policy for Executive Directors, the Committee has considered a number of factors including:

- the importance of attracting, retaining and motivating senior management of the appropriate calibre to further the success of the Bank;
- the linking of reward to both business and individual performance; and
- ensuring that the interests of the Executive Directors are aligned with those of the Bank.

The current policy is to remunerate those Executive Directors who also sit on the CFS Board in line with the market median for similar sized main board roles in the Financial Services Sector, and to remunerate other Executive Directors, who sit on the Bank Board only, at the Financial Services Sector market median.

In 2005, the Committee considered a valuation of all elements of Executive Directors' remuneration, including pension benefits, to ensure that it was aware of their total remuneration in comparison with relevant external comparators, and appropriate remuneration covering all major components of their reward package. The Committee considers that a successful remuneration policy needs to be sufficiently flexible to take account of future changes in the Bank's business environment, and in comparative remuneration practice.

The main components of Executive Directors' remuneration are:

1) Basic Salary

It is the Committee's policy to ensure that the basic salary for each Executive Director is appropriate and competitive for the responsibilities involved. Base salaries for Executive Directors are reviewed by the Committee, normally annually, having regard to competitive market practice (in particular salary levels for similar positions in comparable companies), business and individual performance during the financial year. The normal salary review date for those Executive Directors who also sit on the CFS Board (CFS Executive Directors) is at the start of each financial year in January, and on 1 April for other Executive Directors. Base salary is the only element of remuneration that is pensionable. Salaries received by Executive Directors during the financial year are set out in Table 1 on page 41.

2) Annual incentive plan

Each Executive Director is eligible to participate in an annual performance related incentive plan. The Committee reviews and sets incentive targets and levels of eligibility annually. The target level under the scheme for the 2005 financial year was 35% of base salary for CFS Executive Directors, including the Chief Executive, and 25% for other Bank Executive Directors. There is a maximum bonus potential for CFS Executive Directors of 60% of base salary for substantially exceeding targets, (including the Chief Executive) and 40% for other Bank Executive Directors.

For CFS Executive Directors targets in the bonus year 2005, 70% of the reward related to financial performance measured by CFS' shareholder profit (including that contributed by the Bank and CIS' General Insurance Business) and CIS' life fund performance with weightings appropriate to each area and 30% to individual performance. For the Chief Operating Officer of the Bank and Bank Executive Directors, 30% and 40% respectively of their maximum bonus was weighted to their business unit performance, and 70% and 60% respectively to CFS' performance. For the CFS Chief Executive, the ratio was 90% against CFS performance, and 10% based on wider Co-operative Group initiatives.

The ratios are being reviewed for 2006. The payments for the annual incentive plan in respect of the year 2005 are reflected in Table 1 within "Performance Related Pay."

3) Medium term incentive plan

A medium term incentive plan was introduced in 2003 for both CFS Executive Directors and for Executive Directors of the Bank in order to align their objectives with the longer-term interests of the business. The plan sets targets across a three-year period, 2003-2005. Performance against these targets is reviewed by the Committee on an annual basis. Annual profit performance must be at or above "Threshold" level for payment to be made. Targets for subsequent three-year periods are then set. The second three-year period of operation of the plan was 2004-2006 with potential payment in 2007. The target annualised payment level under the plan for CFS Executive Directors, including the Chief Executive, for that three-year period (and subsequent years) is 28% of basic salary with a stretch level of 42% of basic salary for substantially out-performing targets. Equivalent figures for Bank Executive Directors are 20% and 30%. The first potential payment under the plan 2003-2005 would be made in 2006 on the basis disclosed in the 2003 Remuneration Report.

The performance measures selected by the Committee are specific projects related to delivery of strategic objectives, derived from CFS' Strategic Plan which is updated annually. The performance measures are based on the achievement of milestones and objectives linked to strategically important projects, and on the maintenance of financial objectives.

4) Service agreements

It is the Bank's policy for the notice period in Executive Directors' Service Contracts not to exceed one year. CFS Executive Directors have consistent contracts which are terminable by up to one year's notice by the organisation and six months' notice by the individual. Payment in lieu of notice includes salary, benefits in kind and pension. The Remuneration & Appointments Committee may make a discretionary award of outstanding bonus payments earned up to the date of termination of employment.

All the Bank Executive Directors had similar contracts during 2005. The dates of existing contracts or dates of appointment are shown in Table 1.

It is the Committee's policy to apply service contracts for any newly recruited Executive Directors in a similar form to the model which has been developed for existing Executive Directors.

The Finance Act 2004 introduced significant changes to the way in which benefits can be provided from approved pension schemes. These changes will take effect from 6 April 2006 and, in preparation for this, a review of Executive Directors' pension arrangements has been undertaken during 2005.

Share Options

The Bank does not operate a Share Option Scheme.

Non-Executive Directorships

The Committee has determined that Executive Directors may accept one Non-Executive directorship, or similar, with an external organisation believing that this represents an important opportunity for professional development. Throughout his term of office as Acting Chief Executive, Paul Hewitt held one Non-Executive directorship. Any fees received from such a role will normally be paid to the Bank, CFS or the Co-operative Group.

Pensions

All the Executive Directors [except Paul Hewitt, who is a member of the Co-operative Group (CWS) Limited Pension Fund ('the Group Fund'), and David Anderson] are members of The Co-operative Bank Pension Scheme ('the Scheme'). The Scheme and the Group Fund are funded, Inland Revenue approved, defined benefit final salary occupational pension schemes. Members of the Group Fund are required to contribute. Existing members of the Scheme have been required to contribute since January 2005. Pension details of the Executive Directors are shown in Table 2.

The pension arrangements broadly provide a pension of two-thirds of final pensionable salary after 40 years' service, subject to the tax rules. However, the pensions for John Marper and Sheila Macdonald accrued at an enhanced rate. Pensions are also payable to dependants on death and a lump sum is payable if death occurs in service.

Unfunded, unapproved arrangements were in place to provide pension benefits to those Executive Directors affected by the pensions cap, except for Paul Hewitt and John Reizenstein. These arrangements were designed to provide pensions benefits in excess of the cap, thereby placing those Executive Directors in broadly the same position as those whose pension is unaffected by the cap. The pension benefits for Paul Hewitt and John Reizenstein are limited to the cap but they are paid a salary supplement of 30% and 15% of salary above the cap respectively, in lieu of pension benefits above the cap.

Supplementary life assurance cover is provided to CFS Executive Directors in order to provide total life cover of 4 x salary when aggregated with Scheme benefits.

The normal retirement age of the Executive Directors is 60.

In common with the majority of other UK employers, the Group faces increasing costs and risks in the provision of occupational pension schemes for its employees, including Executives. In view of this, a strategic review of employee pension provision was completed during 2005. The review covered pension arrangements for all employees, including Executives, in the Group and its financial services subsidiaries, Co-operative Financial Services, Co-operative Insurance Society and the Bank.

As a consequence of this review, some significant changes to the Group's occupational pension arrangements will be implemented with effect from 6 April 2006, with the approval of the Trustees of the Co-operative Group Pension Fund, the CIS Employees' Pension Scheme and The Co-operative Bank Pension Scheme (the Existing Schemes).

The key proposed changes are:

- the Existing Schemes will transfer into a new pension scheme on 6 April 2006;
- the new scheme, the Co-operative Group Pension (Average Career Earnings) Scheme (PACE), will be available to all employees of the Trading Group and Financial Services businesses. It will provide pensions and other benefits based on Career Average Earnings, revalued for inflation, in respect of pensionable service from 6 April 2006;
- Executives and employees will be provided with benefits from PACE on the same terms;
- accrued benefits under the Existing Schemes as at 5 April 2006 will continue to be linked to final pensionable salary at the Executive's or employee's actual date of leaving or retirement, whichever is earlier; and
- PACE members will contribute 6% of their pensionable salary.

The PACE scheme will maintain a competitive level of pension provision whilst controlling the future costs and risks of occupational pension provision.

Non-Executive Directors

All the Non-Executive Directors are appointed, and their Directors' fees are determined and paid, by the Co-operative Group. Details of the Directors' fees are shown in table 3.

The Bank Board includes four Independent Professional Non-Executive Directors, who are:

- David Davies was appointed to the Board on 3 June 2003. In addition, he was appointed as Senior Independent Non-Executive Director on 23 February 2005 for which he receives an additional fee;
- Tony Lancaster was appointed to the Board on 27 May 2004;
- Graham Stow was appointed to the Board on 4 March 2003; and
- Piers Williamson was appointed as an Independent Professional Non-Executive Director on 1 July 2005.

Details of their remuneration are also shown in table 3.

Of the Non-Executive Directors only the Independent Professional Non-Executive Directors are party to agreements with the Co-operative Group governing the terms on which their services are made available to the Bank.

- Graham Stow holds a three-year agreement effective up to 31 May 2006;
- David Davies had a three-year agreement effective up to 31 May 2006. This has been extended up to the end of the Co-operative Group's Annual General Meeting in 2007 with approval of the Co-operative Group Board following his appointment as Senior Independent Director, with effect from 23 February 2005;
- Tony Lancaster holds a three-year agreement, effective up to 31 May 2007;
- Piers Williamson holds a three-year agreement, effective up to 31 May 2008.

The Co-operative Group Board may resolve to reappoint any of the Independent Professional Non-Executive Directors at or before the date their contracts expire for a further three-year term.

The agreements contain no specific provision for liquidated damages on early termination of a contract.

None of the above Directors are Directors of the Co-operative Group or members of any Group Pension Scheme or Incentive Plan.

Table 1 – Executive Directors' emoluments

	Date of service contract or appointment	Basic Salary	Performance related pay		Benefits in kind	2005 Total emoluments	2004 Total emoluments
			Annual	Medium term			
		£'000	£'000	£'000	£'000	£'000	£'000
David Anderson (1) (5) (6)	1 June 2005	398	193	–	60	651	–
Paul Hewitt (3) (5) (6) (8)	16 December 2004	229	112	–	11	352	37
Sheila Macdonald (4) (5) (6) (9)	6 January 2005	277	137	157	21	592	319
Richard Goddard (4) (7)	8 November 2002	132	44	36	11	223	145
John Marper (4) (5) (6) (9)	6 January 2005	258	126	153	24	561	300
Peter Sutcliffe (4) (7) (9)	10 January 2003	146	47	39	13	245	163
John Reizenstein (5) (6) (7) (8)	6 January 2005	309	147	140	26	622	115
Craig Shannon (5) (6)	11 February 2005	293	151	170	22	636	110
		2,042	**957**	**695**	**188**	**3,882**	**1,189**
Former Directors who served the Bank in 2004(2)		–	–		–	–	581
Compensation for loss of office(9)		958	–		–	958	–
Amounts attributable to fellow subsidiaries		(1,630)	(1,043)		(121)	(2,794)	(1,035)
		1,370	609		67	2,046	735

Notes:

Note 1 Appointed on 1 June 2005. Emoluments paid by the Society's ultimate parent organisation – the Co-operative Group

Note 2 As reported in the 2004 Financial Statements, Sir Mervyn Pedelty resigned as a Bank Board Director with effect from 15 December 2004 and was entitled to payments amounting to £294,125, excluding pension (see table 2).

Note 3 Appointed Acting Chief Executive for the period 16 December 2004 until 1 June 2005. The amounts included in the table above relate to the period up to 1 June 2005.

Note 4 Resigned as an Executive Director on 14 January 2006.

Note 5 The emoluments in the table represent total basic pay, benefits in kind and performance related pay in respect of services for each individual as a Director of the Bank, CFS and CIS. Of these emoluments, 15% (25% for John Reizenstein and 80% for Sheila Macdonald) have been apportioned to the Bank and 85% (75% for John Reizenstein and 20% for Sheila Macdonald) of the emoluments have been recharged to fellow group companies in respect of services as a Director or Senior Manager of CIS and CFS.

Note 6 Executive Directors who also sit, or who have sat, on the CFS Board during the financial year.

Note 7 Benefits in kind includes a car allowance which is paid with base salary, but is not pensionable.

Note 8 The basic salary figures for David Anderson, Paul Hewitt and John Reizenstein include a salary supplement in lieu of certain pension benefits.

Note 9 Compensation paid for loss of office was in respect of Sheila Macdonald £485,000; John Marper £288,000; Peter Sutcliffe £185,000

Table 2 – Pension details of the Executive Directors

	Age at 14 January 2006	Years of Service	Total accrued pension at 14 January 2006	Increase in accrued pension during the year	Increase in accrued pension during the year (net of inflation)	Transfer value of previous column at 14 January 2006 net of member's contributions	Transfer Value of total accrued pension at 8 January 2005	Transfer Value of total accrued pension at 14 January 2006	Increase in transfer value less members contributions
			£'000	£'000	£'000	£'000	£'000	£'000	£'000
David Anderson (4)	50	0	–	–	–	–	–	–	–
Paul Hewitt (5)	49	0	4	1	1	6	33	39	4
Sheila Macdonald	58	26	133	12	8	147	1,956	2,385	424
Richard Goddard	48	12	36	4	3	34	313	388	72
John Marper	59	16	90	6	4	72	1,442	1,726	279
Peter Sutcliffe	59	33	80	6	4	64	1,242	1,479	235
John Reizenstein	49	2	5	2	2	16	26	51	19
Craig Shannon	42	2	14	5	5	31	68	113	39

Notes:

Note 1 The total accrued pension is that which would be paid annually on retirement at normal retirement aged based on service to 14 January 2006 and includes any transferred in benefits as appropriate.

Note 2 Members of the Pension Scheme have the option of paying additional voluntary contributions within the tax rules. Neither these contributions nor the benefits arising from them are shown on the above table.

Note 3 All transfer values have been calculated in accordance with Actuarial Guidance Note GN11.

Note 4 David Anderson was appointed as Chief Executive on 1 June 2005. He has chosen not to join an occupational pension scheme and is paid a non-pensionable salary supplement of 15% of basic salary in lieu of pension provision.

Note 5 Paul Hewitt ceased to be Acting Chief Executive on 31 May 2005 and his pension details are calculated as at that date.

Note 6 Sir Mervyn Pedelty resigned as an Executive Director with effect from 15 December 2004. In the year ending 14 January 2006 he exercised his option to take the value of his unfunded, unapproved pension as a taxable lump sum of £2.815m rather than as a pension.

Table 3 – Non-Executive Directors' remuneration

Non-Executive Directors	Date Appointed		Term expires	Fee £'000
	Bank	CIS		
Graham Bennett	1989	2000	2006	15
Simon Butler	2003	1999	2008	15
Terry Morton	2006	1998	2008	8
Kathryn Smith	2001	2006	2006	8
Len Wardle	2006	2001	2007	8
Steve Watts	2006	2000	2007	8
Bob Burlton (1)	2004	2003	2008	0

Professional Non-Executive Directors	Date Appointed		Term expires	Fee £000
	Bank	CIS		
Graham Stow	2003	2003	2006	42
David Davies	2003	2003	2006	46
Tony Lancaster	2004	2004	2007	41
Piers Williamson	2005	2005	2008	23

Notes:

Note 1 Bob Burlton's fee is paid as a combined fee in respect of his position as Chair of the Co-operative Group and was paid to his nominating Society – The Midcounties Co-operative (formally Oxford, Swindon and Gloucester Society).

Note 2 In addition, Martin Beaumont, Chief Executive of the Co-operative Group and Paul Hewitt, Deputy Chief Executive of the Co-operative Group, serve as Non-Executive Directors of The Co-operative Bank and CIS; remuneration is paid by the Co-operative Group in respect of these appointments.

By Order of the Board
Bob Burlton, Chair, CFS Remuneration & Appointments Committee
Graham Bennett, Chair, The Co-operative Bank
6 April 2006

Independent Auditor's report to the members of The Co-operative Bank p.l.c.

We have audited the group and parent company financial statements (the "financial statements") of The Co-operative Bank p.l.c. for the year ended 14 January 2006 which comprise the Group Income Statement, the Group and Parent Company Balance Sheets, the Group and Parent Company Cash Flow Statements, the Group and Parent Company Statements of Recognised Income and Expense and the related notes. These financial statements have been prepared under the accounting policies set out therein.

This report is made solely to the company's members, as a body, in accordance with section 235 of the Companies Act 1985. 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.

Respective responsibilities of Directors and auditors

The Directors' responsibilities for preparing the Annual Report and the financial statements in accordance with applicable law and International Financial Reporting Standards (IFRSs) as adopted by the EU are set out in the Statement of Directors' Responsibilities on page 30.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Companies Act 1985. We also report to you if, in our opinion, the Directors' Report is not consistent with the financial statements, if the company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and other transactions is not disclosed.

In addition to our audit of the financial statements, the Directors have engaged us to review their corporate governance statement as if the company were required to comply with the Listing Rules of the Financial Services Authority in relation to these matters. We review whether the Corporate Governance Statement reflects the company's compliance with the nine provisions of the 2003 FRC Combined Code specified for our review by those rules, and we report if it does not. We are not required by the terms of our engagement to consider whether the board's statements on internal control cover all risks and controls, or form an opinion on the effectiveness of the group's corporate governance procedures or its risk and control procedures.

We read other information contained in the Annual Report and consider whether it is consistent with the audited financial statements. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. Our responsibilities do not extend to any other information.

Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgments made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the group's and company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

Opinion

In our opinion:

- the group financial statements give a true and fair view, in accordance with IFRSs as adopted by the EU, of the state of the group's affairs as at 14 January 2006 and of its profit for the year then ended;
- the parent company financial statements give a true and fair view, in accordance with IFRSs as adopted by the EU as applied in accordance with the provisions of the Companies Act 1985, of the state of the parent company's affairs as at 14 January 2006; and
- the financial statements have been properly prepared in accordance with the Companies Act 1985.

KPMG Audit Plc
Chartered Accountants
Registered Auditor
Manchester
6 April 2006

Consolidated statutory income statement

For the year ended 14 January 2006
All amounts are stated in £m unless otherwise indicated

	Notes	**2005**	2004
Interest and similar income		**669.4**	592.6
Interest expense and similar charges		**(348.9)**	(267.6)
Net Interest Income	4	**320.5**	325.0
Fee and commission income		**239.8**	229.4
Fee and commission expense		**(39.1)**	(49.7)
Net fee and commission income		**200.7**	179.7
Dividend income		**0.3**	0.3
Net trading income	5	**4.9**	4.1
Operating income		**526.4**	509.1
Operating expenses	6	**(328.8)**	(319.7)
Profit before impairment losses		**197.6**	189.4
Impairment losses on loans and advances	12	**(99.8)**	(62.8)
Operating profit		**97.8**	126.6
Profit based payments to members of the Co-operative Group		**(1.3)**	–
Profit before taxation		**96.5**	126.6
Income tax expense	8	**(30.9)**	(38.0)
Profit for the period		**65.6**	88.6
Attributable to:			
Equity shareholders	9	**63.2**	81.0
Minority interests		**2.4**	2.1
Preference shareholders		**–**	5.5
		65.6	88.6
Earnings per share (basic and fully diluted)	10	**5.75p**	7.36p

The notes on pages 52 to 87 form part of these financial statements

Consolidated statutory balance sheet

At 14 January 2006
All amounts are stated in £m unless otherwise indicated

	Notes	2005	2004
Assets			
Cash and balances at central banks		**200.2**	172.4
Loans and advances to banks	11	**1,170.7**	1,181.1
Loans and advances to customers	12	**7,923.8**	7,612.1
Debt securities – Available for sale	13	**2,269.1**	1,676.8
Derivative financial instruments	14	**68.2**	12.3
Equity shares	15	**1.2**	1.2
Interests in associated undertakings	16	**–**	0.2
Intangible fixed assets	17	**6.6**	8.3
Property, plant and equipment	18	**86.1**	85.7
Deferred tax assets	26	**27.6**	33.1
Other assets	19	**23.9**	29.4
Prepayments & accrued income		**75.6**	86.3
Total assets		**11,853.0**	10,898.9
Liabilities			
Deposits by banks	20	**634.7**	655.0
Customer accounts	21	**8,818.8**	8,098.7
Debt securities in issue	22	**1,050.2**	771.7
Derivative financial instruments	14	**63.7**	21.2
Other borrowed funds	23	**338.1**	327.6
Other liabilities	24	**110.0**	89.1
Accruals and deferred income		**81.8**	160.1
Provision for liabilities	25	**6.1**	6.9
Current tax liabilities		**18.1**	23.5
Deferred tax liabilities	26	**12.8**	9.9
Retirement benefit obligations	27	**92.1**	110.4
Total liabilities		**11,226.4**	10,274.1
Capital and reserves attributable to the Company's equity holders			
Ordinary Share capital	28	**55.0**	55.0
Share premium account	28	**8.8**	8.8
Preference shares		**–**	60.0
Retained earnings	29	**527.9**	480.9
Other reserves	29	**12.0**	–
		603.7	604.7
Minority interests		**22.9**	20.1
Total equity		**626.6**	624.8
Total liabilities and equity		**11,853.0**	10,898.9

Approved by the Board on 6 April 2006 and signed on its behalf by

Graham Bennett, Chair
David Anderson, Chief Executive
Moira Lees, Secretary

Bank balance sheet

At 14 January 2006
All amounts are stated in £m unless otherwise indicated

	Notes	2005	2004
Assets			
Cash and balances at central banks		**200.2**	172.4
Loans and advances to banks	11	**1,170.6**	1,181.0
Loans and advances to customers	12	**7,807.9**	7,546.2
Debt securities – Available for sale	13	**1,912.8**	1,378.3
Derivative financial instruments	14	**68.3**	12.5
Equity shares	15	**1.2**	1.2
Shares in Group undertakings	32	**2.7**	1.2
Intangible fixed assets	17	**6.6**	8.3
Property, plant and equipment	18	**79.8**	79.0
Deferred tax assets	26	**27.0**	32.4
Other assets	19	**23.9**	28.9
Prepayments & accrued income		**64.1**	77.2
Total assets		**11,365.1**	10,518.6
Liabilities			
Deposits by banks	20	**641.1**	666.9
Customer accounts	21	**8,391.7**	7,778.5
Debt securities in issue	22	**1,050.2**	771.7
Derivative financial instruments	14	**64.3**	21.7
Other borrowed funds	23	**338.1**	327.6
Other liabilities	24	**108.9**	86.7
Accruals and deferred income		**71.5**	141.7
Provision for liabilities	25	**5.2**	6.0
Current tax liabilities		**15.7**	21.6
Deferred tax liabilities	26	**5.9**	2.4
Retirement benefit obligations	27	**90.0**	107.9
Total liabilities		**10,782.6**	9,932.7
Capital and reserves attributable to the Company's equity holders			
Ordinary Share capital	28	**55.0**	55.0
Share premium account	28	**8.8**	8.8
Preference shares		**–**	60.0
Retained earnings	29	**506.8**	462.1
Other reserves	29	**11.9**	–
Total equity		**582.5**	585.9
Total liabilities and equity		**11,365.1**	10,518.6

Approved by the Board on 6 April 2006 and signed on its behalf by

Graham Bennett, Chair
David Anderson, Chief Executive
Moira Lees, Secretary

The notes on pages 52 to 87 form part of these financial statements

All amounts are stated in £m unless otherwise indicated

Statement of recognised income and expense

	Group 2005	Group 2004	Bank 2005	Bank 2004
Effective portion of cashflow hedges transferred to equity	**4.5**	–	**4.3**	–
Cashflow hedges transferred to profit or loss	**–**	–	**–**	–
Available for sale investments				
Valuation gains/losses taken to equity	**(0.2)**	–	**(0.1)**	–
Valuation gains/losses transferred to profit or loss on sale	**(0.7)**	–	**(0.7)**	–
Net movement in pension fund deficit due to actuarial gains and losses, net of tax	**13.4**	19.1	**13.1**	18.7
Net income recognised directly in equity	**17.0**	**19.1**	**16.6**	**18.7**
Net profit – equity shareholders	**63.2**	81.0	**60.9**	78.7
Net profit – minority interests	**2.4**	2.1	**–**	–
Net profit – preference shareholders	**–**	5.5	**–**	5.5
Total recognised income and expense for the year	**82.6**	**107.7**	**77.5**	**102.9**
Effect of change in accounting policy				
Effect of adoption of IAS32 and IAS39 net of tax on 9 January 2005 (with 2004 not restated) on:				
Share capital	**–**		**–**	
Share premium	**–**		**–**	
Cash flow hedge reserve	**3.7**		**3.6**	
Available for sale reserve	**4.8**		**4.8**	
Retained earnings	**(10.6)**		**(10.5)**	
Minority interest	**0.4**		**–**	
Total recognised income and expense for the year is attributable to:				
Equity shareholders	**79.9**	99.7	**77.5**	97.4
Minority interests	**2.7**	2.5	**–**	–
Preference shareholders	**–**	5.5	**–**	5.5
	82.6	**107.7**	**77.5**	**102.9**

Consolidated cash flow statement

For the year ended 14 January 2006
All amounts are stated in £m unless otherwise indicated

	2005	2004
Cash flows from operating activities		
Profit before taxation	**96.5**	**126.6**
Decrease/(Increase) in prepayments and accrued income	**10.7**	(9.0)
(Decrease)/Increase in accruals and deferred income	**(75.8)**	15.4
Interest payable in respect of subordinated liabilities	**23.2**	21.0
Effect of exchange rate movements	**(4.4)**	(4.3)
Effect of non-cash pension costs	**0.9**	(7.2)
Impairment losses on loans and advances	**99.8**	62.8
Depreciation and amortisation	**24.7**	22.7
Interest amortisation	**(4.4)**	–
Amortisation of investments	**(0.1)**	1.4
Profit on sale of investments	**(1.0)**	(6.4)
Loss on disposal of Fixed Assets	**0.8**	–
Preference dividend	**5.6**	–
	176.5	223.0
Decrease in deposits by banks	**(30.5)**	(115.1)
Increase in customer accounts	**716.8**	713.3
Increase in debt securities in issue	**278.5**	547.0
Increase in loans and advances to banks	**(120.0)**	(45.0)
Increase in loans and advances to customers	**(416.9)**	(1,542.1)
Decrease in trading debt securities	**–**	735.1
Net movement of other assets and other liabilities	**23.2**	34.9
United Kingdom corporation tax paid	**(34.5)**	(33.4)
Net cash flow from operating activities	**593.1**	**517.7**
Cash flows from investing activities		
Purchase of property, equipment and software	**(26.5)**	(26.9)
Proceeds from sale of property and equipment	**0.4**	0.1
Purchase of debt securities	**(7,531.2)**	(951.8)
Proceeds from sale and maturity of debt securities	**6,590.3**	1,036.9
Net cash flow from investing activities	**(967.0)**	**58.3**
Cash flows from financing activities		
Interest paid in respect of subordinated loanstock	**(23.6)**	(13.6)
Repayment of subordinated loanstock	**(50.0)**	–
Issue of subordinated loanstock	**–**	147.9
Ordinary share dividends paid	**(18.8)**	(15.0)
Preference dividends paid	**(5.6)**	(5.6)
Dividends from associated undertakings	**0.2**	–
Dividends paid to minority shareholders in subsidiary undertaking	**(0.9)**	(0.8)
Net cash flow from financing	**(98.7)**	**112.9**
(Decrease)/Increase in cash and cash equivalents	**(472.6)**	**688.9**
Cash and cash equivalents at the beginning of the year	**1,713.5**	1,024.6
Cash and cash equivalents at end of year	**1,240.9**	1,713.5
Cash and balances with central banks	**200.2**	172.4
Loans and advances to banks (note 11)	**945.7**	1,076.1
Short term investments (note 13)	**95.0**	465.0
	1,240.9	**1,713.5**

The notes on pages 52 to 87 form part of these financial statements

Bank cash flow statement

For the year ended 14 January 2006
All amounts are stated in £m unless otherwise indicated

	2005	2004
Cash flows from operating activities		
Profit before taxation	**88.5**	119.9
Decrease/(Increase)in prepayments and accrued income	**13.0**	(19.0)
(Decrease)/Increase in accruals and deferred income	**(67.9)**	11.3
Interest payable in respect of subordinated liabilities	**23.2**	21.0
Effect of exchange rate movements	**(4.4)**	(4.3)
Effect of non-cash pension costs	**0.9**	5.4
Impairment losses on loans and advances	**99.8**	62.6
Depreciation and amortisation	**24.0**	22.0
Interest amortisation	**(4.5)**	–
Amortisation of investments	**(0.1)**	1.4
Profit on sale of investments	**(1.0)**	(6.2)
Loss on disposal of Fixed Assets	**0.7**	–
Preference dividend	**5.6**	–
	177.8	214.1
Decrease in deposits by banks	**(35.9)**	(106.8)
Increase in customer accounts	**610.0**	652.3
Increase in debt securities in issue	**278.5**	547.0
Increase in loans and advances to banks	**(120.0)**	(45.0)
Increase in loans and advances to customers	**(366.7)**	(1,535.8)
Decrease in trading debt securities	**–**	760.1
Net movement of other assets and other liabilities	**22.8**	23.0
United Kingdom corporation tax paid	**(31.7)**	(30.9)
Net cash flow from operating activities	**534.8**	**478.0**
Cash flows from investing activities		
Purchase of property, equipment and software	**(26.2)**	(26.7)
Proceeds from sale of property and equipment	**0.4**	–
Purchase of debt securities	**(6,854.2)**	(431.3)
Proceeds from sale and maturity of debt securities	**5,986.1**	584.8
Investment in subsidiary	**(1.5)**	–
Net cash flow from investing activities	**(895.4)**	**126.8**
Cash flows from financing activities		
Interest paid in respect of subordinated loanstock	**(23.5)**	(13.6)
Repayment of subordinated loanstock	**(50.0)**	–
Issue of subordinated loanstock	**–**	147.9
Ordinary share dividends paid	**(18.8)**	(15.0)
Preference dividends paid	**(5.6)**	(5.6)
Dividends from associated undertakings	**0.9**	0.3
Net cash flow from financing	**(97.0)**	**114.0**
(Decrease)/Increase in cash and cash equivalents	**(457.6)**	**718.8**
Cash and cash equivalents at the beginning of the year	**1,698.4**	979.6
Cash and cash equivalents at end of year	**1,240.8**	1,698.4

	2005	2004
Cash and balances with central banks	**200.2**	172.4
Loans and advances to banks (note 11)	**945.6**	1,076.0
Short term investments (note 13)	**95.0**	450.0
	1,240.8	1,698.4

The notes on pages 52 to 87 form part of these financial statements

All amounts are stated in £m unless otherwise indicated

Background

The Bank first adopted IFRS in 2005, with a date of transition to IFRS of 11 January 2004.
The Bank's last financial statements under UK GAAP were for the year ended 8 January 2005.
The Bank has applied IAS32 and IAS39 from 9 January 2005.

Changes to accounting policies

The paragraphs below set out the main changes to accounting policies due to the implementation of IFRS, compared to the previous UK GAAP treatment. The impacts are shown in the tables below and the reconciliations on page 87.

(a) Employee benefits
Under IAS19, a provision is made in full for any pension fund deficit. This provision was not recognised under SSAP 24 'Accounting for pension costs'.

(b) Effective interest rate
IAS39 requires the interest recognised on all financial instruments measured at amortised cost to be calculated using the effective interest rate that achieves a level yield to maturity. Under UK GAAP, interest and related fees and costs were recognised on an accruals basis.

(c) Impairment provision
IAS39 only allows a provision, on a discounted cash flow basis, to be made if there is objective evidence of impairment at the balance sheet date. Under UK GAAP, anticipated recoveries were not discounted.

(d) Available for sale classification
Under IFRS, items classified as available for sale must be carried at their fair value. Changes in fair value are passed through equity. Under UK GAAP, they were carried at amortised cost or at fair value with movements recognised in the profit and loss account.

(e) Preference shares
IAS32 requires the Bank's preference shares to be classified as a liability and the dividend thereon treated as interest expense. Under UK GAAP, they were classified as part of shareholders' funds and dividends shown as an appropriation of profit.

(f) Non-trading derivatives
Under IAS39, non-trading derivatives are held on the balance sheet at fair value with changes in fair value recognised in the income statement unless cash flow hedging can be applied, in which case movements in fair value pass through equity. Previously, non-trading derivatives were not recognised on the balance sheet.

(g) Dividends
Under IFRS, dividends are not recognised until declared or paid. Under UK GAAP, dividends were accrued when proposed.

	Group		Bank	
Reconciliation of equity	**At 8 January 2005**	At 11 January 2004	**At 8 January 2005**	At 11 January 2004
As previously reported under UK GAAP	**702.2**	636.2	**661.5**	599.0
Recognition of pension fund deficit	(82.4)	(97.6)	(80.4)	(95.4)
Post year end declared dividends	5.0	–	5.0	–
Other	–	(0.1)	(0.2)	(0.1)
Equity under IFRS as at 8 January 2005	**624.8**	538.5	**585.9**	503.5
Application of IAS32 and IAS39*				
Reclassification of preference shares	(60.0)	–	(60.0)	–
Income recognition	2.6	–	2.6	–
Debt impairment	(9.3)	–	(9.5)	–
Mark to market changes	7.3	–	7.1	–
Other	(2.3)	–	(2.3)	–
Restated equity under IFRS at 9 January 2005	**563.1**	538.5	**523.8**	503.5

All amounts are stated in £m unless otherwise indicated

Reconciliation of profit for the period

	Group Year ended 8 January 2005	Bank Year ended 8 January 2005
As previously reported under UK GAAP	**92.4**	**88.0**
Recognition of pension fund deficit	**(3.9)**	**(3.8)**
Lease income recognition	**0.1**	**–**
	88.6	**84.2**

Material adjustments to the cash flow statement

For the purpose of the cash flow statement, the statement shows the movement in cash and cash equivalents rather than movements only in cash. Cash equivalents include wholesale assets with an original maturity of less than 3 months.

This has increased Group cash and cash equivalents by £884.0 million and £1,543.5 million at 10 January 2004 and 8 January 2005 respectively.

*As stated in the basis of preparation on page 52, IAS32 and IAS39 were adopted from 9 January 2005.

Introduction

Following the adoption of IAS Regulation EC 1606/2002 in July 2002 by the European Parliament, the Bank, along with all other European entities listed on an EU regulated market, is required to prepare consolidated financial statements in accordance with International Financial Reporting Standards ('IFRS') as endorsed by the European Union ('EU') for the year ended 14 January 2006.

The Bank has prepared one year of comparative figures under IFRS and hence the Bank's date of transition to IFRS is 11 January 2004 and the first annual reporting period under IFRS is for the year to 14 January 2006. This report therefore contains the consolidated financial results for the year ended 14 January 2006 on the basis of IFRS, and comparatives for the year ended 8 January 2005 restated to IFRS.

Basis of preparation

Both the parent company financial statements and the group financial statements have been prepared and approved by the directors in accordance with IFRS as adopted by the EU ('Adopted IFRS'). On including the parent company financial statements here together with the group financial statements, the company is taking advantage of the exemption in S230 of the Companies Act 1985 not to present its individual income statement and related notes that form a part of these approved financial statements. Information in respect of the company alone is labelled throughout as 'Bank'.

The financial information has been prepared on the basis of recognition and measurement requirements of IFRS in issue that are endorsed by the EU and effective at 14 January 2006.

The Bank has adopted IAS32 'Financial Instruments: Disclosure and Presentation' and IAS39 'Financial Instruments: Recognition and Measurement' from 9 January 2005. Comparatives for 2004 have not been restated to reflect the requirements of IAS32 and IAS39 and, as permitted by IFRS1, financial instruments are accounted for under UK GAAP in accordance with the accounting policies set out in the annual financial statements for the year ended 8 January 2005.

An explanation of how the transition to IFRS has affected the accounting policies, reported financial position, financial performance and cash flows of the Bank is provided on pages 50 and 51. This includes reconciliations of equity and profit or loss for the comparative period reported under UK GAAP to those reported under IFRS and descriptions of accounting policies applied under UK GAAP.

Standards and Interpretations issued but not yet effective

The Group has adopted early the amendment to IAS19: actuarial gains and losses, group plans and disclosure.

The following Standards, amendments and interpretations have been issued, but are not effective in the EU. The impact of these amendments on the Group financial statements has not yet been quantified but is expected to be immaterial.

Compliance with the following standards is voluntary for 2005 and mandatory for 2007. The EU had not endorsed these standards by 14 January 2006:

- IAS1 'Presentation of Financial Statements' – Capital Disclosures: Disclosures amendment to IAS1 issued by the IASB in August 2005 and effective for periods beginning on or after 1 January 2006, and ;
- IFRS 7 'Financial Instruments: Disclosures': Disclosure requirements relating to financial instruments which supersedes IAS30 Disclosures in the Financial Statements of Banks and Similar Financial Institutions, issued by the IASB in August 2005 and effective for annual periods beginning on or after 1 January 2007.

These two statements relate to disclosures only, and adoption of them would have no impact on the Group or Company Income Statements, Balance Sheets or Cash Flow Statements.

The Group has not adopted the following statements;

- IFRIC4 'Determining Whether an Arrangement Contains a Lease': This interpretation specifies that arrangements which contain a lease should be accounted for in accordance with IAS17, 'Leases'. Issued in January 2005, the amendments are effective for annual periods beginning on or after 1 January 2007.
- Amendments to IAS39 and IFRS 4 'Financial Guarantee Contracts': issued in August 2005 this standard relates to the accounting for financial guarantee contracts, a financial guarantee contract being a contract which requires the issuer to make payments to reimburse any loss of the holder in respect of payment failure. The amendments are effective for annual periods beginning on or after 1 January 2006.
- IAS39 'Financial Instruments: recognition and measurement – The Fair Value Option': issued in June 2005 this amendment restricts the use of the fair value option to financial instruments that meet certain conditions. The amendments are effective for annual periods beginning on or after 1 January 2006.

Accounting date

The financial statements of the Bank and the Group relate to the 53 weeks to 14 January 2006. Since the Bank and Group accounting date is virtually co-terminous with the calendar year 2005, the financial year's figures are headed 2005 and the corresponding amounts for the 52 weeks to 8 January 2005 are headed 2004.

Significant accounting policies

The preparation of the consolidated results in accordance with adopted IFRS resulted in changes to the accounting policies as compared with the most recent annual financial statements prepared under UK GAAP. As a result of the IFRS1 exemption to not restate comparatives for IAS32 and IAS39, certain accounting policies only apply from 9 January 2005 and do not apply to the comparatives.This is the only exemption taken under IFRS1. These policies have been denoted with an asterisk. The policy applied for 2004 can be found in the 2004 financial statements. A summary of previous policies can be found on page 50.

(a) Revenue recognition*

Interest income

Interest income is recognised on an effective interest rate (EIR) basis, inclusive of directly attributable incremental transaction costs and fees, and discounts and premiums where appropriate.

The EIR basis spreads the interest income over the expected life of the instrument. The EIR is the rate that, at the inception of the instrument, exactly discounts expected future cash payments and receipts through the expected life of the instrument back to the initial carrying amount. When calculating the EIR, the Group estimates cash flows considering all contractual terms of the instrument (for example prepayment options) but does not consider future credit losses.

Fees and commissions

Unless included in the effective interest calculation, fees and commissions are recognised on an accruals basis when the service has been 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.

(b) Financial instruments (excluding derivatives)*

The Bank classifies its financial assets (excluding derivatives) as either

1. Loans and receivables;
2. Available for sale; or
3. Financial assets at fair value through profit or loss

No assets are classified as held-to-maturity.

The Group measures all of its financial liabilities at amortised cost, other than those within the wholesale trading portfolio, which are measured at fair value through profit or loss.

1. Loans and receivables

   Loans and receivables to customers and banks (except for specific assets designated at fair value through profit or loss – see below), are measured at amortised cost, being the amount advanced plus any unpaid interest, commissions and fees charged to the customer less amounts repaid or written off; less impairment provisions for incurred losses and adjusted for the cumulative amortisation arising from effective interest rate adjustments. Effective interest rate adjustments arise when future cash flows are discounted through the expected life of the financial instrument.

2. Available for sale

   Available for sale financial assets are non-traded investment securities, intended to be held for an indefinite period of time. These are measured at fair value with movements in the carrying value brought into equity as they arise, except for changes in value arising from impairment and foreign exchange gains and losses on monetary items which are recognised in the income statement. On disposal, gains and losses recognised previously in equity are transferred to the income statement.

3. Financial assets at fair value through profit or loss

   These are either:

- Acquired or incurred principally for the purpose of selling or repurchasing in the near term; or
- Part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent actual pattern of short-term profit taking; or
- Upon initial recognition designated at fair value through profit or loss to eliminate or significantly reduce a measurement or recognition inconsistency.

These are measured at fair value with movements in the carrying value brought into the income statement within interest income as they arise.

Impairment provision

Bank assesses at the balance sheet date its financial assets (including loans and advances to customers) for objective evidence that an impairment loss has been incurred.

The amount of the loss is the difference between:

- Asset's carrying amount; and
- Present value of estimated future cash flows (discounted at the asset's original or variable effective interest rate).

The amount of the impairment loss 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.

The written down value of the impaired loan is compounded back to the net realisable balance over time using the original effective interest rate. This is reported through interest and similar income within the income statement and represents the unwind of the discount.

A write-off is made when all or part of a claim is deemed uncollectible or forgiven. Write-offs are charged against previously established provisions for impairment or directly to the income statement.

(c) Offsetting*

Financial assets and financial liabilities are offset and the net amount reported in the balance sheet when there is a legally enforceable right to offset the recognised amounts and there is an intention to settle on a net basis, or realise the asset and settle the liability simultaneously.

(d) Derivative financial instruments and hedge accounting*

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.

Derivative financial instruments are stated at fair value. 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.

Embedded derivatives: A derivative may be embedded in another financial 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, the embedded derivative is separated from the host and held on balance sheet at fair value. Movements in fair value are posted to the income statement, whilst the host contract is accounted for according to the policy for that class of financial instrument.

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.

Cumulative amounts recognised through equity are recycled to the income statement in the period in which the underlying hedged item matures and its associated gain or loss affects the income statement. When a hedging relationship is broken or the hedge becomes ineffective, the cumulative unrealised gain or loss remaining in equity continues to be held in equity, and is transferred to the income statement only when the forecast transaction is recognised.

Fair values are based on quoted market prices in active markets, and where these are not available, using valuation techniques such as discounted cash flow models.

Derivatives used for trading purposes

Derivatives entered into for trading purposes include swaps, forward rate agreements, futures, options and combinations of these instruments. Derivatives used for trading purposes are measured at fair value and any gains or losses are included in the income statement. The use of derivatives and their sale to customers as risk management products is an integral part of the Bank's trading activities.

Fair values are based on quoted market prices in active markets, and where these are not available, using valuation techniques such as discounted cash flow models.

(e) Property, plant and equipment

Items of property, plant and equipment are stated at cost less any accumulated depreciation.

Depreciation is provided on a straight line basis at the following rates, which are estimated to write down the assets to realisable values at the end of their useful lives.

Freehold and long leasehold buildings	2.5 per cent per annum
Short leasehold buildings	life of lease
Equipment	10 to 33.3 per cent per annum
Vehicles	25 per cent per annum

(f) Intangible assets – *Computer software*

Costs incurred in the development of computer software for internal use are capitalised and classified as intangible assets where they are not an integral part of the related hardware and amortised over their useful life, which is generally 3 years.

(g) Assets leased to customers – *Finance leases*

Assets leased to customers are included within 'loans and advances to customers' and valued at an amount equal to the net investment in the lease, less any provisions for impairment.

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.

(h) Cash and cash equivalents

Cash and cash equivalents comprises cash balances and balances with an original maturity of three months or less.

(i) Deferred taxation

Income tax on the profit or loss for the periods presented comprises current and deferred tax. Income tax 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 equity.

Deferred tax is provided using the balance sheet liability method, providing for temporary differences between the carrying amounts of assets and liabilities in the consolidated financial statements and the amounts used for taxation purposes.

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. Deferred taxes are determined using the rates enacted or substantively enacted at the balance sheet date.

(j) Pension costs

The Bank's net obligation in respect of defined benefit pension plans is calculated by estimating the amount of future benefit that employees have earned in return for their service in the current and prior periods. The benefit is discounted to determine its present value, and the fair value of any plan assets is deducted.

The discount rate used is the market yield on high quality corporate bonds at the balance sheet date that have maturity dates approximating to the terms of the Group's obligation. The calculation is performed by a qualified actuary using the projected unit credit method.

All actuarial gains and losses at 11 January 2004, the date of transition to IFRS, were recognised. The Bank recognises actuarial gains and losses that arise subsequent to 11 January 2004 through equity.

The charge to the income statement includes current service cost, past service cost, the interest cost of the scheme liabilities and the expected return on scheme assets.

(k) Exchange rates

Balances in foreign currencies are expressed in sterling at the rate ruling at the balance sheet date. All exchange differences are dealt with in the income statement.

(l) Borrowed funds*

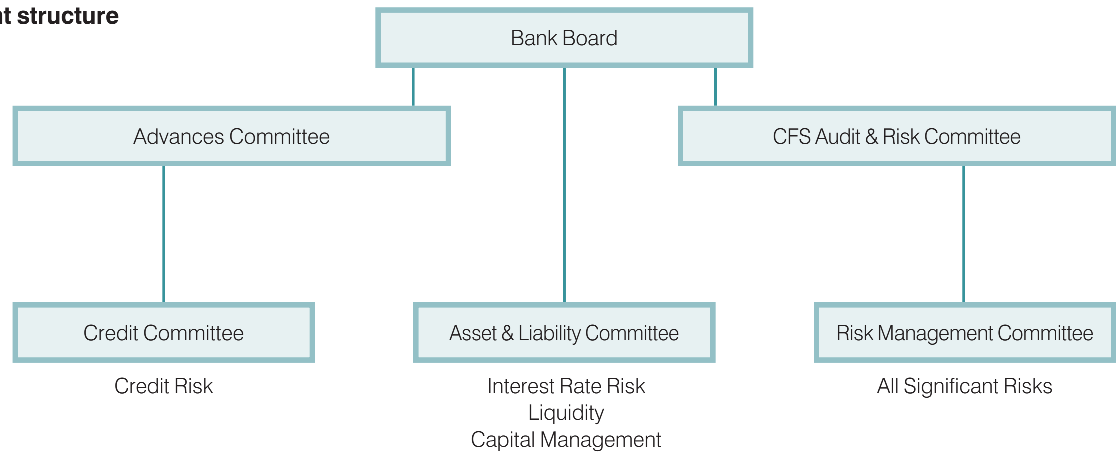
Borrowings are recognised initially at issue proceeds net of transaction costs incurred.

Borrowings are subsequently stated at amortised cost; any difference between proceeds net of transaction costs and the redemption value is recognised in the income statement over the period of the borrowings using the effective interest method.

The Bank's preference shares are classified as financial liabilities and are presented in other borrowed funds. The dividends on these preference shares are recognised in the income statement as interest expense on an amortised cost basis using the effective interest method.

Risk management framework
The Board is responsible for approving the Bank's strategy, its principal markets and the level of acceptable risks. The Board has established Board Committees and Senior Management Committees to administer a risk management process which identifies the key risks facing the business and reviews reports submitted to those Committees on how those risks are being managed. Specific authority has been delegated to Board Committees and the Chief Executive who may, in turn, delegate elements of his discretions to appropriate Executive Directors and their senior line managers.

Risk management structure



Advances Committee is a Board sub-committee, chaired by a non-executive director. It assesses and approves transactions that exceed the delegated authority of the Chief Executive and reviews key features of the lending portfolios and related credit strategy.

CFS Audit & Risk Committee is a CFS Board sub-committee, chaired by a non-executive director. It also supports the Bank Board in carrying out its responsibilities for internal control and risk assessment. The Committee monitors the ongoing process of the identification, evaluation and management of all significant risks across the Bank and provides an independent review of risk management and controls. The Committee is supported by Group Internal Audit and Risk Management functions.

Risk Management Committee now comprises a minimum of two Bank Directors, along with risk managers responsible for specific types of risk within the Bank. The Committee advises the CFS Audit & Risk Committee.

Credit Committee was chaired in 2005 by the former CFS Risk & Compliance Director (now chaired by the Director of Capital Pricing and Risk-Banking) and included the Bank's former Credit Risk & Compliance Management Director and Heads of Credit. The Chair has delegated authority for approving credit facilities within approved credit strategies and delegated authorities.

Asset & Liability Committee (ALCO) is chaired by the Chief Financial Officer. It is primarily responsible for managing the interest rate risk inherent in the Bank's asset and liability portfolio, liquidity and capital management.

The Bank's significant risks arise in four broad categories:-
- Credit risk
- Market risk
- Liquidity risk
- Operational risk

Credit risk arises from the possibility of customers and counterparties failing to meet their obligations to the Bank and represents the most significant category of risk.

The Credit Risk Management Policies are approved by the Board annually and determine the criteria for the management of personal, corporate and wholesale market exposures. They specify credit management standards, including country, sector and counterparty limits, along with delegated authorities. Larger corporate facilities are sanctioned by the Board's Advances Committee who also review, each month, facilities granted within the Chief Executive's discretion.
The Bank's personal lending policy is to establish credit criteria which determine the optimum balance between volume growth (generating higher income) and higher bad debts, so as to maximise overall profitability. Personal lending is tightly controlled through advanced credit and behavioural scoring techniques administered by a specialist department. The Advances Committee receives regular reports on the performance of the portfolio.

All amounts are stated in £m unless otherwise indicated

The Bank's corporate sector policy is to maintain a broad sectoral spread of exposures which reflect the Bank's areas of expertise. Credit exposures to corporate and business banking customers are assessed individually. The quality of the overall portfolio is monitored, using a credit grading system calibrated to the probability of incurring losses. All aspects of credit management are controlled centrally. The Advances Committee receives regular reports on new facilities and changes in facilities, sector exposures, bad debt provisions and the realisation of problem loans.

Credit policy for wholesale market counterparties involves establishing limits for each of these counterparties based on their financial strength and credit rating. Counterparty limits are largely uncommitted. All counterparties are reviewed at least annually by the Treasury Credit Department and the counterparty list is also reviewed annually by the Advances Committee.

Credit exposure

14 January 2006	Group Gross balance	Group Credit commitments	Group **Credit risk exposure**	Bank Gross balance	Bank Credit commitments	Bank **Credit risk exposure**
Loans and advances to banks	1,170.7	2.0	1,172.7	1,170.6	2.0	1,172.6
Loans and advances to customers	8,080.2	6,125.8	14,206.0	7,964.1	6,110.0	14,074.1
Debt securities – Available for sale	2,269.1	–	2,269.1	1,912.8	–	1,912.8
Derivative financial instruments	68.2	–	68.2	68.3	–	68.3
	11,588.2	**6,127.8**	**17,716.0**	**11,115.8**	**6,112.0**	**17,227.8**

Market risk

Market risk arises from the effect of changes in market prices of financial instruments, on income derived from the structure of the balance sheet, execution of customer and inter-bank business and proprietary trading. The majority of the risk arises from changes in interest rates as the Bank does not trade in equities or commodities and has limited foreign currency activities.

Interest Rate Risk Policy Statements, approved by the Audit & Risk Committee on behalf of the Board, specify the scope of the Bank's wholesale market activity, market risk limits and delegated authorities. The policy is executed by the Bank's ALCO whose Chair has been delegated authority by the Chief Executive. ALCO meets monthly and its prime task is to assess the interest rate risk inherent in the maturity and re-pricing characteristics of the Bank's assets and liabilities. It sets limits within which Treasury and the Bank's Asset and Liability Management department manage the effect of interest rate changes on the Bank's overall net interest income. The principal analytical techniques involve assessing the impact of different interest rate scenarios and changes in balances over various time periods.

Treasury executes funding and hedging transactions with the wholesale markets on behalf of the Bank and its customers. It also generates incremental income from proprietary trading within strict risk limits. There are two prime measures of risk supplemented by additional controls such as maturity and stop loss limits. Risk units express the various re-pricing and maturity mismatches as a common unit of measurement. Value at Risk (VaR) measures the daily maximum potential gain or loss due to recent market volatility to a statistical confidence level of 95% and uses 250 days of historical data and a one day holding period. During 2005, the daily VaR in the trading portfolios was less than £0.8 million. The VaR methodology has inherent limitations in that market volatility in the past may not be a reliable predictor of the future, and may not reflect the time required to hedge or dispose of the position, hence VaR is not used by the Bank as the sole measure of risk.
The Board receive quarterly reports on the management of Balance Sheet risk and, each month, ALCO reviews the Balance Sheet risk position and the utilisation of wholesale market risk limits.

In 2004 Treasury Risk Management introduced PV01 as an additional risk measure to supplement VaR. This risk measure is based upon a full revaluation and indicates the change in value of a fixed income product, or portfolio, given a 1 basis point movement in interest rates.

Trading value at risk:
At 14 January 2006, total Treasury VaR of **£0.4 million** (2004 – £0.3 million) represents the maximum potential daily gain or loss in market rates within a confidence level of 95% based on recent market performance. The average, highest and lowest VaR, as calculated on a daily basis, for the accounting period ended 14 January 2006 were **£0.4 million** (2004 – £0.5million), **£0.8 million** (2004 – £1.3million) and **£0.2 million** (2004 – £0.2million).

All amounts are stated in £m unless otherwise indicated

Currency risk

The Bank's Treasury foreign exchange activities are primarily:

- Providing a service in meeting the foreign exchange requirements of customers;
- Maintaining liquidity in euros and dollars by raising funds and investing these to generate a return; and
- Performing limited intra-day trading and overnight positioning in major currencies to generate incremental income.

The table below provides an analysis of the Group's and Bank's assets and liabilities by currency at 14 January 2006.

14 January 2006	**Group £**	**$**	**€**	**Other**	**Total**	**Bank £**	**$**	**€**	**Other**	**Total**
Assets										
Cash and balances at central banks	197.8	–	2.4	–	200.2	197.8	–	2.4	–	200.2
Loans and advances to banks	952.1	216.3	0.5	1.8	1,170.7	952.0	216.3	0.5	1.8	1,170.6
Loans and advances to customers	7,829.9	42.6	47.6	3.7	7,923.8	7,714.0	42.6	47.6	3.7	7,807.9
Debt securities – Available for sale	1,796.9	472.2	–	–	2,269.1	1,440.6	472.2	–	–	1,912.8
Derivative financial instruments	67.9	0.3	–	–	68.2	68.0	0.3	–	–	68.3
Equity shares	1.2	–	–	–	1.2	1.2	–	–	–	1.2
Interests in associated undertakings	–	–	–	–	–	2.7	–	–	–	2.7
Intangible fixed assets	6.6	–	–	–	6.6	6.6	–	–	–	6.6
Property, plant and equipment	86.1	–	–	–	86.1	79.8	–	–	–	79.8
Deferred tax assets	27.6	–	–	–	27.6	27.0	–	–	–	27.0
Other assets	16.3	7.4	0.2	–	23.9	16.3	7.4	0.2	–	23.9
Prepayments & accrued income	75.6	–	–	–	75.6	64.1	–	–	–	64.1
Total assets	**11,058.0**	**738.8**	**50.7**	**5.5**	**11,853.0**	**10,570.1**	**738.8**	**50.7**	**5.5**	**11,365.1**
Liabilities										
Deposits by banks	478.9	127.0	28.0	0.8	634.7	485.3	127.0	28.0	0.8	641.1
Customer accounts	8,781.7	17.6	18.1	1.4	8,818.8	8,354.6	17.6	18.1	1.4	8,391.7
Debt securities in issue	459.4	590.8	–	–	1,050.2	459.4	590.8	–	–	1,050.2
Derivative financial instruments	61.8	1.9	–	–	63.7	62.4	1.9	–	–	64.3
Other borrowed funds	338.1	–	–	–	338.1	338.1	–	–	–	338.1
Other liabilities	107.9	2.1	–	–	110.0	106.8	2.1	–	–	108.9
Accruals and deferred income	81.7	–	0.1	–	81.8	71.4	–	0.1	–	71.5
Provisions for liabilities	6.1	–	–	–	6.1	5.2	–	–	–	5.2
Current tax liabilities	18.1	–	–	–	18.1	15.7	–	–	–	15.7
Deferred tax liabilities	12.8	–	–	–	12.8	5.9	–	–	–	5.9
Retirement benefit obligations	92.1	–	–	–	92.1	90.0	–	–	–	90.0
Total liabilities	**10,438.6**	**739.4**	**46.2**	**2.2**	**11,226.4**	**9,994.8**	**739.4**	**46.2**	**2.2**	**10,782.6**
Net on - balance sheet position	**619.4**	**(0.6)**	**4.5**	**3.3**	**626.6**	**575.3**	**(0.6)**	**4.5**	**3.3**	**582.5**

At 14 January 2006 the Group's open position was **£0.6 million** (2004 – £2.1 million) representing a potential loss of **£0.02 million** given a 3% appreciation in sterling (2004 – loss of £0.06 million given an appreciation in sterling).

Interest rate risk

The table below summarises the effective interest rate for monetary financial instruments. These represent gross rates and do not take account of funding or interest rate hedging and so do not reflect economic margins earned.

	Group and Bank
Assets	
Cash and balances at central banks	–
Treasury bills and other eligible bills	5.0%
Loans and advances to banks	4.5%
Loans and advances to customers	6.9%
Debt securities – available for sale	4.7%
Liabilities	
Deposits by banks	4.2%
Customer accounts	3.0%
Debt securities in issue	4.5%
Other borrowed funds	7.4%

For the year ended 14 January 2006
All amounts are stated in £m unless otherwise indicated

Interest rate sensitivity gap:

The table below summarises the repricing periods for the assets and liabilities. Items are allocated to time bands by reference to the earlier of the next contractual interest rate repricing date and the maturity date.

Group

14 January 2006	**Within 3 months**	**Over 3 months but within 6 months**	**Over 6 months but within 1 year**	**Over 1 year but within 5 years**	**More than 5 years**	**Non-interest bearing**	**Trading book**	**Total**
Assets:								
Loans and advances to banks	932.9	100.0	125.0	–	–	12.8	–	1,170.7
Loans and advances to customers	5,473.2	261.1	260.2	1,612.2	317.1	–	–	7,923.8
Debt securities and equity shares	1,000.4	243.5	668.8	342.7	14.9	–	–	2,270.3
Other assets	200.2	–	–	–	–	256.7	31.3	488.2
Loans to trading book	2.5	–	–	–	–	2.2	(4.7)	–
Total assets	**7,609.2**	**604.6**	**1,054.0**	**1,954.9**	**332.0**	**271.7**	**26.6**	**11,853.0**
Liabilities:								
Deposits by banks	627.8	–	–	–	–	6.9	–	634.7
Customer accounts	6,809.0	62.1	374.2	226.4	–	1,347.1	–	8,818.8
Debt securities in issue	852.2	193.0	5.0	–	–	–	–	1,050.2
Other borrowed funds	30.0	–	100.0	–	210.0	(1.9)	–	338.1
Other liabilities	–	–	–	–	–	358.0	26.6	384.6
Equity	–	–	–	–	–	626.6	–	626.6
Total liabilities	**8,319.0**	**255.1**	**479.2**	**226.4**	**210.0**	**2,336.7**	**26.6**	**11,853.0**
Derivatives	**(758.0)**	**(391.5)**	**430.0**	**585.5**	**134.0**	**–**		
Interest rate sensitivity gap	**(1,467.8)**	**(42.0)**	**1,004.8**	**2,314.0**	**256.0**	**(2,065.0)**		
Cumulative gap	**(1,467.8)**	**(1,509.8)**	**(505.0)**	**1,809.0**	**2,065.0**	**–**		
8 January 2005								
Assets:								
Loans and advances to banks	1,070.5	100.0	–	–	–	10.6	–	1,181.1
Loans and advances to customers	5,498.3	171.5	295.4	1,338.1	308.8	–	–	7,612.1
Debt securities and equity shares	470.2	102.3	243.1	306.2	25.8	–	530.4	1,678.0
Other assets	172.0	–	–	–	–	208.5	47.2	427.7
Loans to trading book	450.8	80.2	–	–	–	7.0	(538.0)	–
Total assets	**7,661.8**	**454.0**	**538.5**	**1,644.3**	**334.6**	**226.1**	**39.6**	**10,898.9**
Liabilities:								
Deposits by banks	644.2	–	1.0	2.0	–	7.8	–	655.0
Customer accounts	6,393.5	50.4	95.2	231.9	–	1,327.7	–	8,098.7
Debt securities in issue	714.7	52.0	5.0	–	–	–	–	771.7
Other borrowed funds	30.0	–	50.0	100.0	150.0	(2.4)	–	327.6
Other liabilities	–	–	–	–	–	381.5	39.6	421.1
Equity	–	–	–	–	60.0	564.8	–	624.8
Total liabilities and equity	**7,782.4**	**102.4**	**151.2**	**333.9**	**210.0**	**2,279.4**	**39.6**	**10,898.9**
Derivatives	**(455.3)**	**(275.1)**	**(10.7)**	**656.1**	**85.0**	**–**	**–**	
Interest rate sensitivity gap	**(575.9)**	**76.5**	**376.6**	**1,966.5**	**209.6**	**(2,053.3)**	**–**	
Cumulative gap	**(575.9)**	**(499.4)**	**(122.8)**	**1,843.7**	**2,053.3**	**–**	**–**	

All amounts are stated in £m unless otherwise indicated

Interest rate sensitivity gap (continued)

Bank

14 January 2006

	Within 3 months	Over 3 months but within 6 months	Over 6 months but within 1 year	Over 1 year but within 5 years	More than 5 years	Non-interest bearing	Trading book	Total
Assets:								
Loans and advances to banks	932.8	100.0	125.0	–	–	12.8	–	1,170.6
Loans and advances to customers	5,378.9	265.7	264.4	1,612.8	286.1	–	–	7,807.9
Debt securities and equity shares	749.4	193.2	613.8	342.7	14.9	–	–	1,914.0
Other assets	200.2	–	–	–	–	241.1	31.3	472.6
Loans to trading book	2.5	–	–	–	–	2.2	(4.7)	–
Total assets	**7,263.8**	**558.9**	**1,003.2**	**1,955.5**	**301.0**	**256.1**	**26.6**	**11,365.1**
Liabilities:								
Deposits by banks	634.2	–	–	–	–	6.9	–	641.1
Customer accounts	6,381.9	62.1	374.2	226.4	–	1,347.1	–	8,391.7
Debt securities in issue	852.2	193.0	5.0	–	–	–	–	1,050.2
Other borrowed funds	30.0	–	100.0	–	210.0	(1.9)	–	338.1
Other liabilities	–	–	–	–	–	334.9	26.6	361.5
Equity	–	–	–	–	–	582.5	–	582.5
Total liabilities and equity	**7,898.3**	**255.1**	**479.2**	**226.4**	**210.0**	**2,269.5**	**26.6**	**11,365.1**
Derivatives	**(708.0)**	**(386.5)**	**420.0**	**540.5**	**134.0**	**–**		
Interest rate sensitivity gap	**(1,342.5)**	**(82.7)**	**944.0**	**2,269.6**	**225.0**	**(2,013.4)**		
Cumulative gap	**(1,342.5)**	**(1,425.2)**	**(481.2)**	**1,788.4**	**2,013.4**	**–**		

The period end position shown above is regarded as materially representative of the Group's and Bank's position throughout the year and reflects the policies on risk management, subject to the following comments:

– The gap analysis disclosed reflects contractual repricing in accordance with accounting standards.
– Interest free current account balances are included in the 'non-interest bearing' maturity band.
– The Group's asset and liability policies reflect the historic stability of customer accounts.

Liquidity risk

14 January 2006

	Repayable on demand	3 months or less but not repayable on demand	1 year or less but over 3 months	5 years or less but over 1 year	Over 5 years	Non cash items	Total
Group							
Assets							
Loans and advances to banks	2.7	933.1	225.0	–	9.9	–	1,170.7
Loans and advances to customers	750.1	1,133.7	706.6	1,927.4	3,562.4	(156.4)	7,923.8
Debt securities – Available for sale	–	581.4	1,003.4	664.0	20.3	–	2,269.1
Other assets	268.4	–	–	–	–	221.0	489.4
	1,021.2	**2,648.2**	**1,935.0**	**2,591.4**	**3,592.6**	**64.6**	**11,853.0**
Liabilities							
Deposits by banks	44.1	584.1	6.5	–	–	–	634.7
Customer accounts	6,598.4	2,087.7	100.1	32.6	–	–	8,818.8
Debt securities in issue	–	688.8	61.5	299.9	–	–	1,050.2
Other borrowed funds	–	–	100.0	30.0	210.0	(1.9)	338.1
Other liabilities	63.7	–	–	–	–	320.9	384.6
	6,706.2	**3,360.6**	**268.1**	**362.5**	**210.0**	**319.0**	**11,226.4**
Net liquidity gap	**(5,685.0)**	**(712.4)**	**1,666.9**	**2,228.9**	**3,382.6**	**(254.4)**	**626.6**

All amounts are stated in £m unless otherwise indicated

Liquidity risk (continued)

14 January 2006	**Repayable on demand**	**3 months or less but not repayable on demand**	**1 year or less but over 3 months**	**5 years or less but over 1 year**	**Over 5 years**	**Non cash items**	**Total**
Bank							
Assets							
Loans and advances to banks	2.7	933.0	225.0	–	9.9	–	1,170.6
Loans and advances to customers	686.9	1,171.8	700.8	1,902.0	3,502.6	(156.2)	7,807.9
Debt securities – Available for sale	–	330.3	898.2	664.0	20.3	–	1,912.8
Other assets	268.5	–	–	–	–	205.3	473.8
	958.1	**2,435.1**	**1,824.0**	**2,566.0**	**3,532.8**	**49.1**	**11,365.1**
Liabilities							
Deposits by banks	44.1	590.5	6.5	–	–	–	641.1
Customer accounts	6,275.4	1,983.6	100.1	32.6	–	–	8,391.7
Debt securities in issue	–	688.8	61.5	299.9	–	–	1,050.2
Other borrowed funds	–	–	100.0	30.0	210.0	(1.9)	338.1
Other liabilities	64.3	–	–	–	–	297.2	361.5
	6,383.8	**3,262.9**	**268.1**	**362.5**	**210.0**	**295.3**	**10,782.6**
Net liquidity gap	**(5,425.7)**	**(827.8)**	**1,555.9**	**2,203.5**	**3,322.8**	**(246.2)**	**582.5**

8 January 2005	**Repayable on demand**	**3 months or less but not repayable on demand**	**1 year or less but over 3 months**	**5 years or less but over 1 year**	**Over 5 years**	**Non cash items**	**Total**
Group							
Assets							
Loans and advances to banks	4.5	1,067.0	100.0	–	9.6	–	1,181.1
Loans and advances to customers	657.1	931.3	657.2	1,913.2	3,569.8	(116.5)	7,612.1
Debt securities – Available for sale	–	589.5	433.0	627.3	27.0	–	1,676.8
Other assets	184.7	–	–	–	–	244.2	428.9
	846.3	**2,587.8**	**1,190.2**	**2,540.5**	**3,606.4**	**127.7**	**10,898.9**
Liabilities							
Deposits by banks	52.4	601.6	1.0	–	–	–	655.0
Customer accounts	5,673.9	2,224.9	141.3	58.6	–	–	8,098.7
Debt securities in issue	–	415.5	56.4	299.8	–	–	771.7
Other borrowed funds	–	–	50.0	130.0	150.0	(2.4)	327.6
Other liabilities	21.2	–	–	–	–	399.9	421.1
	5,747.5	**3,242.0**	**248.7**	**488.4**	**150.0**	**397.5**	**10,274.1**
Net liquidity gap	**(4,901.2)**	**(654.2)**	**941.5**	**2,052.1**	**3,456.4**	**(269.8)**	**624.8**

All amounts are stated in £m unless otherwise indicated

Liquidity risk (continued)

8 January 2005	**Repayable on demand**	**3 months or less but not repayable on demand**	**1 year or less but over 3 months**	**5 years or less but over 1 year**	**Over 5 years**	**Non cash items**	**Total**
Bank							
Assets							
Loans and advances to banks	4.5	1,066.9	100.0	–	9.6	–	1,181.0
Loans and advances to customers	641.7	983.6	649.5	1,883.4	3,503.5	(115.5)	7,546.2
Debt securities – Available for sale	–	420.0	304.0	627.3	27.0	–	1,378.3
Other assets	184.9	–	–	–	–	228.2	413.1
	831.1	**2,470.5**	**1,053.5**	**2,510.7**	**3,540.1**	**112.7**	**10,518.6**
Liabilities							
Deposits by banks	52.4	613.5	1.0	–	–	–	666.9
Customer accounts	5,454.9	2,124.1	141.0	58.5	–	–	7,778.5
Debt securities in issue	–	415.5	56.4	299.8	–	–	771.7
Other borrowed funds	–	–	50.0	130.0	150.0	(2.4)	327.6
Other liabilities	21.7	–	–	–	–	366.3	388.0
	5,529.0	3,153.1	248.4	488.3	150.0	363.9	9,932.7
Net liquidity gap	**(4,697.9)**	**(682.6)**	**805.1**	**2,022.4**	**3,390.1**	**(251.2)**	**585.9**

Liquidity risk arises from the timing of cash flows generated from the Group's assets, liabilities and off-balance sheet instruments. Treasury manages the Group's liquidity within guidelines laid down by ALCO and in accordance with the standards established for all banks by banking regulators. Short-term liquidity standards ensure the Group can always meet its obligations without recourse to the wholesale markets for at least the next five working days.

The Group's liquidity management policies are reviewed and approved annually by the Audit & Risk Committee and reviewed monthly by ALCO.

The table above analyses the Group's assets and liabilities into relevant maturity groupings based on the remaining period at the balance sheet date to the contractual maturity date.

The Group's liquidity risk management is on a behavioural basis which analyses customer demand deposits over their expected repayment period. These demand deposits are shown as repayable on demand in the analysis above.

Operational risk arises from the potential for key systems failures, breaches in internal controls or from external events resulting in financial loss or reputational damage. Key operational risks include outsourced contracts, payment systems and information systems. Operational risk is controlled and mitigated through comprehensive, ongoing risk management practices which include formal internal control procedures, training, segregation of duties, delegated authorities and contingency planning. In addition, significant operational risk assessments are conducted as part of the ongoing Significant Risk identification, monitoring and evaluation process. All significant operational risks are regularly reported to Executive Directors and to the Audit & Risk Committee, who also receive regular reports from the Internal Audit Department based on their own programme of operational reviews.

The Executive Directors are responsible for controlling the operating risks within their direct areas of accountability and for compliance with Bank policies, which are extensively documented in Procedures Manuals.

All amounts are stated in £m unless otherwise indicated

Fair values of financial assets and liabilities (IAS39)

The table below sets out a comparison of the book value and the fair value at 14 January 2006 of all of the Group's financial instruments, where book value does not equate to fair value.

	Group Carrying value	Fair value	Bank Carrying value	Fair value
Financial assets				
Loans and advances to banks	1,170.7	1,170.7	1,170.6	1,170.6
Loans and advances to customers	7,923.8	7,950.5	7,807.9	7,832.6
Financial liabilities				
Deposits by banks	634.7	634.7	641.1	641.1
Customer accounts	8,818.8	8,819.0	8,391.7	8,391.9
Debt securities in issue	1,050.2	1,050.9	1,050.2	1,050.9
Other borrowed funds	338.1	383.4	338.1	383.4

(a) Loans and advances to banks

Loans and advances to banks include inter-bank placements and items in the course of collection.

The fair value of floating rate placements and overnight deposits is their carrying amount. 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.

(b) Loans and advances to customers

Loans and advances are net of provisions for impairment. The estimated fair value of loans and advances represents the discounted amount of estimated future cash flows expected to be received. Expected cash flows are discounted at current market rates to determine fair value.

(c) Deposits by banks

The fair value of floating rate placements and overnight deposits is their carrying amount. 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 remaining maturity.

(d) 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 price is based on discounted cash flows using interest rates for new debts with similar remaining maturity.

(e) Debt securities in issue and other borrowed funds

The aggregate fair values are calculated based on quoted market prices. For those notes where quoted market prices are not available, a discounted cash flow model is used based on a current yield curve appropriate for the remaining term to maturity.

Additionally, debt securities and derivatives are measured at fair value.

(f) Debt securities

Fair value is based on 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.

(g) Derivatives

Futures and options are marked to market using listed market prices. For interest rate swaps, the estimated fair value is based on discounted cash flows using prevailing money market interest rates for instruments with similar remaining maturity.

Fair values of financial assets and liabilities (FRS 13)

The table below sets out a comparison of the book value and the fair value at 8 January 2005 of all of the Group's financial instruments, derivatives and other financial instruments which have an active and liquid market.

The fair value represents the amount at which the instrument would be exchanged in an arm's length transaction between two willing parties. In the vast majority of cases, quoted market prices are readily available and are used, otherwise prices are obtained by other well established valuation techniques, which utilise present value cash flows.

The fair value will approximate to the carrying value when instruments are carried in the balance sheet at market value or where the instruments are short term or contain frequent repricing provisions.

All amounts are stated in £m unless otherwise indicated

	2004				
	Total	Trading	Non-trading		
Assets	Carrying value	Fair value	Carrying value	Fair value	Accrued Interest
Debt securities	1,676.8	530.4	1,146.4	1,153.5	18.8
Equity shares	1.2	–	1.2	1.2	–
Interest rate derivatives	10.9	9.6	1.3	17.8	15.9
Exchange rate derivatives	1.4	–	1.4	1.4	–
	1,690.3	540.0	1,150.3	1,173.9	34.7
Liabilities					
Debt securities in issue	771.7	–	771.7	772.6	1.3
Non-equity shareholders' funds	60.0	–	60.0	86.9	0.6
Interest rate derivatives	19.7	9.8	9.9	16.1	8.1
Exchange rate derivatives	1.5	–	1.5	1.5	–
	852.9	9.8	843.1	877.1	10.0

The fair values and carrying values shown above exclude accrued interest.

Basel II (Capital Requirements Directive) is an internationally agreed framework for banking regulation and capital management. The FSA plan to finalise guidance on these new standards and implementation requirements in the first half of 2006 in preparation for firms to commence parallel running later in the year with the introduction of the new regulations from 2007 onwards. The Basel II programme is a key risk management development for the Bank in 2006.

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. Risk management procedures are described earlier in this report, and analysis of the financial instruments is provided in the Notes to the Financial Statements. The main financial instruments used by the Bank, and the purposes for which they are held, are outlined below:

Customer loans and deposits

The provision of banking facilities to customers is the prime activity of the Bank and customer loans and deposits are major constituents of the balance sheet. The Bank has detailed policies and procedures to manage risks. In addition to mortgage lending, much of the lending to corporate and business banking customers is secured.

Debt securities, wholesale market loans and deposits

The Bank issues medium term notes within an established Euro Medium Term Note programme and also issues Certificates of Deposit and Commercial Paper as part of its normal Treasury activities. These sources of funds alongside wholesale market loans are invested in marketable, investment grade debt securities, short-term wholesale market placements and used to fund customer loans. Debt securities also underpin the Bank's liquidity requirements and generate incremental net interest and trading income.

Capital funds – Subordinated Note issues and preference shares

The Bank has a policy of maintaining prudent capital ratios and utilises a broad spread of capital funds. In addition to ordinary share capital and retained earnings, the Bank has issued £60 million Preference shares and, when appropriate, also issues perpetual and fixed term Subordinated Notes.

Foreign exchange

The Bank undertakes foreign exchange dealing to facilitate customer requirements and to generate incremental income from short-term trading in the major currencies. Structured risk and trading related risk are managed formally within position limits approved by the Board.

Derivatives

A derivative is an off-balance sheet 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, forward rate agreements, 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.

The Bank makes estimates and assumptions that affect the reported assets and liabilities.
Estimates and judgments are continually assessed and reviewed and are based on historical experience and reasonable expectations of future events.

(a) Impairment on loans and advances

The loan portfolios are reviewed on a continuous basis to assess impairment. In determining whether a bad debt 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 prior to the balance sheet date.

Collective provisions

Personal advances are identified as impaired by taking account of the age of the debt's delinquency, by product type.

The provision is calculated by applying a percentage rate to different categories and ages of impaired debt.

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

Individual provisions

Mortgage accounts are identified as impaired by taking account of the age of the debt's delinquency on a case-by-case basis based on arrears data held within the mortgages system.

Individual provisions are also raised on a case-by-case basis for each mortgage account in arrears.

Each Corporate account is assessed and allocated a 'risk grade' to enable the Bank to monitor the overall quality of its lending assets. Those of lesser quality, where the lending is potentially at risk and provisions for future loss may be required, are centrally monitored with specific management actions taken at each stage within laid down procedures and specific provisioning criteria. Provisions represent the likely net loss after realisation of any security.

(b) Pension fund obligations

The Bank's net obligation in respect of defined benefit pension plans is calculated by estimating the amount of future benefit that employees have earned in return for their service in the current and prior periods.
The pension charge is assessed in accordance with the advice of a qualified actuary using the projected unit method. The assumptions used by the actuary are the best estimates chosen from a range of possible actuarial assumptions which, due to the timescale covered, may not necessarily be borne out in practice.
The assumptions which have the most significant effect on the results of the valuation are those relating to the rate of return used to discount the liabilities and the rate of increase in salaries.
The present value of the scheme obligations is derived from cash flow projections over long periods and is sensitive to the principal assumptions.

All amounts are stated in £m unless otherwise indicated

1. Segmental analysis

The Group's primary basis of segmentation is by business activity.

The Group's activities have been segmented between Personal banking, Corporate and Business banking and Wholesale.

Segment information is presented in the financial statements in respect of the Bank's business segments, reflecting the Bank's management and internal reporting structure.

Income and costs are allocated using transfer pricing and Activity Based Management methodologies.

The Group is comprised of the following main business segments:

- Personal – customer focused products and services for individuals. It includes mortgages, credit cards, consumer loans, current accounts and savings products
- Corporate – customer focused products and services for business accounts. This includes large corporate and commercial entities and SMEs (Small to Medium entities). It includes loans, asset finance, current accounts and savings products
- Wholesale – asset and liability management across the Bank's overall balance sheet, including trading activities.

The 2004 analysis excludes the effects of IAS32 and IAS39 as it is on a statutory basis as explained on page 52. Segmental analysis on a comparable pro-forma basis is included in the Operating and Financial Review on page 14.

				2005	
	Personal	**Corporate**	**Wholesale**	**Central areas**	**Total**
External gross revenue	572.5	204.7	137.2	–	914.4
External net revenue	408.2	133.7	(15.5)	–	526.4
Internal net revenue	(33.5)	(2.9)	36.4	–	–
Total net revenue (including transfer pricing)	374.7	130.8	20.9	–	526.4
Result	38.7	60.7	14.8	–	114.2
Unallocated corporate expenses					(16.4)
Profit based payments to members of the Co-operative Group					(1.3)
Profit before tax					**96.5**
Taxation					(30.9)
Profit after tax					65.6
Other information					
Segmental assets	5,428	2,366	3,610		11,404
Unallocated assets					449
Consolidated assets					11,853
Segmental liabilities	5,025	3,038	2,300		10,363
Unallocated liabilities					863
Consolidated liabilities					11,226
Capital expenditure	20.3	2.7	0.3	1.3	24.6
Depreciation	20.0	2.7	0.1	1.9	24.7

				2004	
	Personal	**Corporate**	**Wholesale**	**Central areas**	**Total**
External gross revenue	527.0	182.5	116.9	–	826.4
External net revenue	377.9	121.5	9.7	–	509.1
Internal net revenue	(20.2)	2.7	17.5	–	–
Total net revenue (including transfer pricing)	357.7	124.2	27.2	–	509.1
Result	60.9	58.1	21.1	–	140.1
Unallocated corporate expenses					(13.5)
Profit before tax					**126.6**
Taxation					(38.0)
Profit after tax					88.6

1. Segmental analysis (continued)

				2004	
	Personal	Corporate	Wholesale	Central areas	Total
Other information					
Segmental assets	5,431	2,105	2,953		10,489
Unallocated assets					410
Consolidated assets					10,899
Segmental liabilities	4,627	2,395	2,524		9,546
Unallocated liabilities					728
Consolidated liabilities					10,274
Capital expenditure	22.7	1.8	–	0.4	24.9
Depreciation and amortisation	17.8	2.7	0.1	2.1	22.7

The Group's activities are in the UK.

2. Profit before taxation

Is stated after.	**2005 £'000**	2004 £'000
Statutory audit services – parent company **£259,000** (2004 – £167,000)	**342**	255
Further assurance services	**240**	349
Other non-audit services	**49**	30
Fees paid to the auditor	**631**	634

3. Directors' emoluments

	2005 £'000	2004 £'000
Non-Executive Directors	**–**	–
Executive Directors	**1,430**	735
Compensation for loss of office	**616**	–
	2,046	735

Retirement benefits are accruing to two Directors (2004 – seven) under defined benefit schemes.

Further details of Directors' emoluments are included in the remuneration report on pages 38 to 42.

4. Net interest income

Included within interest income is Nil (2004 – £2.3 million) with respect of interest income accrued on impaired financial assets and £6.7 million (2004 – Nil) with respect to the unwind of the impairment provision discount.

5. Net trading income

	2005	2004
Foreign exchange	**4.5**	4.3
Interest rate instruments	**0.4**	(0.2)
	4.9	4.1

'Foreign exchange' net trading income includes gains and losses from spot forward and forward contracts, options, futures, and translated foreign currency assets and liabilities.
'Interest rate instruments' includes the result of making markets in instruments in government securities, corporate debt securities, moneymarket instruments, interest rate and currency swaps, options and other derivatives.

6. Operating expenses

	2005	2004
Staff costs (Note 7)	**139.8**	140.1
Administrative expenses	**149.8**	143.6
Depreciation (Note 18)	**21.5**	19.4
Loss on sale of property, plant and equipment	**0.8**	–
Software costs	**3.2**	3.3
Operating lease rentals	**13.7**	13.3
	328.8	319.7

7. Staff costs

	2005	2004
Wages and salaries	**101.9**	98.9
Social security costs	**8.8**	8.3
Pension costs – defined benefit plans	**20.4**	25.0
Other staff costs	**8.7**	7.9
	139.8	140.1

Average number of employees
The average number of persons employed by the group during the year was made up as follows:

	2005	2004
Full time	**3,233**	3,317
Part time	**1,041**	1,039
	4,274	4,356

8. Income tax expense

	2005	2004
Current tax	**29.5**	36.3
Deferred tax (Note 26)	**1.4**	1.7
	30.9	38.0

Further information about deferred income tax is presented in Note 26. The tax on the Group's profit before tax differs from the theoretical amount that would arise using the basic tax rate of the parent as follows:

	2005	2004
Profit before taxation	**96.5**	126.6
Tax calculated at a tax rate of 30% (2004: 30%)	**29.0**	38.0
Preference share interest not deductible for tax purposes	**1.7**	–
Expenses not deductible for tax purposes	**0.6**	0.4
Depreciation of expenditure not qualifying for capital allowances	**0.3**	0.2
Sheltered capital gains	**(0.4)**	–
Non taxable income	**(0.1)**	(0.4)
Adjustments to tax charge in respect of prior periods	**(0.1)**	(0.1)
Other	**(0.1)**	(0.1)
Income tax expense	**30.9**	38.0

9. Group profit attributable to equity shareholders dealt with in the accounts of The Co-operative Bank p.l.c.

£60.9 million (2004 – £78.7 million) of the Group profit attributable to equity shareholders has been dealt with in the accounts of The Co-operative Bank p.l.c.. As permitted by Section 230 of the Companies Act 1985, the profit and loss account of The Co-operative Bank p.l.c. has not been presented separately.

10. Earnings per share

Basic earnings per share is calculated by dividing the net profit attributable to equity holders of the Bank by weighted average number of ordinary shares in issue during the year.

	2005	2004
Profit attributable to equity holders of the Bank	**63.2**	81.0
Weighted average number of ordinary shares in issue (millions)	**1,100.0**	1,100.0
Basic earnings per share (expressed in pence per share)	**5.75**	7.36

All amounts are stated in £m unless otherwise indicated

11. Loans and advances to banks

	Group		Bank	
	2005	2004	**2005**	2004
Items in course of collection from other banks	**125.0**	108.1	**124.9**	108.0
Placements with other banks	**820.7**	968.0	**820.7**	968.0
Included in cash equivalents	**945.7**	1,076.1	**945.6**	1,076.0
Other loans and advances to banks	**225.0**	105.0	**225.0**	105.0
	1,170.7	1,181.1	**1,170.6**	1,181.0
Of which:				
Variable rate	**22.8**	29.3	**22.8**	29.3
Fixed rate	**1,147.9**	1,151.8	**1,147.8**	1,151.7

Mandatory reserve deposits of £9.9m (2004 – £9.6m) are not available for use in the Group's day to day operations and are non-interest bearing.

12. Loans and advances to customers

	Group		Bank	
	2005	2004	**2005**	2004
Gross loans and advances	**8,080.2**	7,728.6	**7,964.1**	7,661.7
Less: allowance for losses on loans and advances	**(156.4)**	(116.2)	**(156.2)**	(115.5)
Less: suspended interest provisions	**–**	(0.3)	**–**	–
	7,923.8	7,612.1	**7,807.9**	7,546.2
Of which:				
Variable rate	**4,470.5**	4,697.6	**4,409.3**	4,699.7
Fixed rate	**3,453.3**	2,914.5	**3,398.6**	2,846.5

Concentration of exposure:

The Group's exposure is virtually all within the United Kingdom. The following industry concentrations of gross advances before provisions are considered significant.

	Group		Bank	
	2005	2004	**2005**	2004
Property and construction	**887.7**	749.3	**887.7**	749.3
Retail distribution and services	**453.7**	535.5	**453.7**	535.5
Business and other services	**1,184.7**	934.4	**1,068.6**	867.5
Personal – unsecured	**2,326.9**	2,217.6	**2,326.9**	2,217.6
Personal – secured	**3,227.2**	3,291.8	**3,227.2**	3,291.8
	8,080.2	7,728.6	**7,964.1**	7,661.7

Allowance for losses on loans and advances

Movement in allowance for losses on loans and advances:

		2005			2004	
	Individual	**Collective**	**Total**	Specific	General	Total
Group:						
At 9 January 2005 (restated for IFRS)	**43.6**	**86.0**	**129.6**	126.2	8.3	134.5
Charge against profits	**11.8**	**88.0**	**99.8**	64.3	(1.5)	62.8
Amounts written off	**(8.0)**	**(62.6)**	**(70.6)**	(81.3)	–	(81.3)
Recoveries	**0.4**	**–**	**0.4**	0.2	–	0.2
Unwind of discount of allowance	**(4.0)**	**(2.7)**	**(6.7)**	–	–	–
Interest charged on impaired loans	**3.9**	**–**	**3.9**	–	–	–
At 14 January 2006	**47.7**	**108.7**	**156.4**	109.4	6.8	116.2

All amounts are stated in £m unless otherwise indicated

12. Loans and advances to customers (continued)

	2005			2004		
	Individual	**Collective**	**Total**	Specific	General	Total
Bank:						
At 9 January 2005 (restated for IFRS)	**43.0**	**86.0**	**129.0**	125.4	8.0	133.4
Acquisitions/transfers	**–**	**–**	**–**	0.2	–	0.2
Charge against profits	**11.8**	**88.0**	**99.8**	64.1	(1.5)	62.6
Amounts written off	**(7.6)**	**(62.6)**	**(70.2)**	(80.8)	–	(80.8)
Recoveries	**0.3**	**–**	**0.3**	0.1	–	0.1
Unwind of discount of allowance	**(3.9)**	**(2.7)**	**(6.6)**	–	–	–
Interest charged on impaired loans	**3.9**	**–**	**3.9**	–	–	–
At 14 January 2006	**47.5**	**108.7**	**156.2**	109.0	6.5	115.5

All provisions are held against loans and advances to customers

	2005	2004
Non-performing debt:		
Group advances	**135.7**	136.5
Allowance for losses on loans and advances	**(88.9)**	(82.7)
	46.8	53.8
Bank advances	**135.4**	135.1
Allowance for losses on loans and advances	**(88.7)**	(82.3)
	46.7	52.8

Group and Bank loans and advances to customers include £55.3m (2004 – Nil) of financial assets at fair value through profit or loss designated at initial recognition to eliminate or significantly reduce a measurement or recognition inconsistency.

Loans and advances to customers include finance lease receivables

	Group		Bank	
	2005	2004	**2005**	2004
Gross investment in finance leases, receivable:				
No later than one year	**63.9**	58.3	**55.8**	47.1
Later than one year and no later than five years	**100.8**	136.3	**70.3**	96.6
Later than five years	**85.6**	99.6	**33.3**	45.8
	250.3	294.2	**159.4**	189.5
Unearned future finance income on finance leases	**(54.3)**	(75.7)	**(21.5)**	(38.1)
Net investment in finance leases	**196.0**	218.5	**137.9**	151.4

The net investment in finance leases may be analysed as follows:				
No later than one year	**52.5**	44.3	**48.6**	38.0
Later than one year and no later than five years	**78.0**	103.7	**60.7**	80.5
Later than five years	**65.5**	70.5	**28.6**	32.9
	196.0	218.5	**137.9**	151.4

All amounts are stated in £m unless otherwise indicated

13. Debt securities – available for sale

	Group				Bank			
	2005		2004		**2005**		2004	
	Balance sheet	**Market value**	Balance sheet	Market value	**Balance sheet**	**Market value**	Balance sheet	Market value
Debt securities								
-listed	**534.5**	**534.5**	488.7	496.3	**534.5**	**534.5**	488.7	496.3
-unlisted	**1,734.6**	**1,734.6**	1,188.1	1,187.6	**1,378.3**	**1,378.3**	889.6	888.8
	2,269.1	**2,269.1**	1,676.8	1,683.9	**1,912.8**	**1,912.8**	1,378.3	1,385.1
Included in cash equivalents	**95.0**		465.0		**95.0**		450.0	

All debt securities are available for sale. There are no held to maturity debt securities.

Listed debt securities available for sale at fair value of Nil (2004: Nil) had been pledged to third parties in sale and repurchase agreements.

Gains and losses from debt securities, included within interest income, comprise:

	2005	2004
Derecognition of available for sale assets	**1.0**	0.6
Amortisation of profit on sale of debt securities	**–**	5.8
	1.0	6.4

The movement in debt securities may be summarised as follows:

	Group	**Bank**
At 8 January 2005	**1,676.8**	**1,378.3**
On application of IAS39	**7.1**	**6.8**
	1,683.9	**1,385.1**
Acquisitions	**7,626.2**	**6,949.2**
Disposals and maturities	**(7,054.2)**	**(6,435.0)**
Exchange adjustments	**14.5**	**14.5**
Amortisation	**0.1**	**0.1**
Fair value movements	**(1.4)**	**(1.1)**
At 14 January 2006	**2,269.1**	**1,912.8**

	Group				Bank			
	2005		2004		**2005**		2004	
	Balance sheet	**Market value**	Balance sheet	Market value	**Balance sheet**	**Market value**	Balance sheet	Market value
Issue								
Issued by public bodies:								
Investment securities:								
Government securities	**53.1**	**53.1**	24.2	28.0	**53.1**	**53.1**	24.2	28.0
Other public sector securities	**11.0**	**11.0**	13.7	16.2	**11.0**	**11.0**	13.7	16.2
	64.1	**64.1**	37.9	44.2	**64.1**	**64.1**	37.9	44.2
Issued by other issuers:								
Investment securities:								
Bank and building society certificates of deposits	**1,731.8**	**1,731.8**	1,185.4	1,185.0	**1,375.5**	**1,375.5**	886.9	886.2
Other debt securities	**473.2**	**473.2**	453.5	454.7	**473.2**	**473.2**	453.5	454.7
	2,205.0	**2,205.0**	1,638.9	1,639.7	**1,848.7**	**1,848.7**	1,340.4	1,340.9
	2,269.1	**2,269.1**	1,676.8	1,683.9	**1,912.8**	**1,912.8**	1,378.3	1,385.1

All amounts are stated in £m unless otherwise indicated

14. Derivative financial instruments

The Bank has entered into various derivatives as principal either as a trading activity, which includes proprietary transactions and customer facilitation, or as a hedging activity for the management of interest rate risk and foreign exchange rate risk.
Positive and negative fair values have not been netted as the Group does not have the legal right of offset.
In line with the requirements of IFRS 1, the following tables have been disclosed for 2004 as reported under UK GAAP.

Derivatives held for trading purposes:
The trading transactions are wholly interest rate related contracts including swaps, caps and floors, forward rate agreements and exchange traded futures. Trading transactions include derivatives where the Bank enters into a transaction to accommodate a customer together with the corresponding hedge transaction.

Non-trading derivatives:
Non-trading transactions comprise derivatives held for hedging purposes to manage the asset and liability positions in the Group. 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.

At 14 January 2006

	Group			Bank		
	Contractual/notional	Fair values		Contractual/notional	Fair values	
	amount	Assets	Liabilities	amount	Assets	Liabilities
1) Derivatives held for trading						
Interest rate derivatives						
Interest rate swaps	1,663.1	4.1	(3.4)	1,783.1	4.9	(4.1)
Over the Counter (OTC) interest rate options	128.0	0.5	(0.5)	128.0	0.5	(0.5)
Total OTC derivatives	1,791.1	4.6	(3.9)	1,911.1	5.4	(4.6)
Exchange-traded interest rate futures	1,500.0	–	–	1,500.0	–	–
Total derivative assets/(liabilities) held for trading	**3,291.1**	**4.6**	**(3.9)**	**3,411.1**	**5.4**	**(4.6)**
2) Derivatives held for hedging						
Derivatives designated as cash flow hedges						
Interest rate swaps	2,618.5	15.6	(3.7)	2,558.5	14.9	(3.6)
Total derivative assets/(liabilities) designated as hedges	**2,618.5**	**15.6**	**(3.7)**	**2,558.5**	**14.9**	**(3.6)**
Derivatives held for non-trading purposes for which hedge accounting has not been applied						
Interest rate swaps	**600.0**	**0.4**	**(8.7)**	**600.0**	**0.4**	**(8.7)**
Embedded derivatives – options	**490.4**	**47.4**	**(47.2)**	**490.4**	**47.4**	**(47.2)**
Forward currency transactions	**115.3**	**0.2**	**(0.2)**	**115.3**	**0.2**	**(0.2)**
Total derivative assets/(liabilities) held for non trading	**3,824.2**	**63.6**	**(59.8)**	**3,764.2**	**62.9**	**(59.7)**
Total recognised derivative assets/(liabilities)	**7,115.3**	**68.2**	**(63.7)**	**7,175.3**	**68.3**	**(64.3)**

The derivatives designated as cash flow hedges are interest rate swaps used to hedge interest rate risk in the Bank's retail lending operations. Cash flows are hedged by quarterly time periods for durations up to ten years.

The Bank had no non-margin exchange traded contracts at the year end (2004 – £Nil).

All amounts are stated in £m unless otherwise indicated

14. Derivative financial instruments (continued)

At 8 January 2005

1)Derivatives held for trading

	Group			Bank		
	Contractual/notional amount	Fair values Assets	Fair values Liabilities	Contractual/notional amount	Fair values Assets	Fair values Liabilities
Interest rate derivatives						
Interest rate swaps	4,949.5	9.1	(9.3)	5,069.5	9.8	(10.0)
OTC interest rate options	147.0	0.5	(0.5)	147.0	0.5	(0.5)
Total OTC derivatives	5,096.5	9.6	(9.8)	5,216.5	10.3	(10.5)
Exchange – traded interest rate futures	3,250.0	–	–	3,250.0	–	–
Total derivative assets/(liabilities) held for trading	**8,346.5**	**9.6**	**(9.8)**	**8,466.5**	**10.3**	**(10.5)**

Maturity of Group over the counter trading contracts

	Notional principal amount	Fair values Assets	Fair values Liabilities
1 year or less	4,633.6	5.3	(6.5)
1 to 5 years	324.2	1.9	(1.4)
Over 5 years	138.7	2.4	(1.9)
	5,096.5	9.6	(9.8)

Counterparty for over the counter trading contracts

	Notional principal amount	Fair values Assets	Fair values Liabilities
Financial institutions	4,896.2	6.3	(9.4)
Non-financial institutions	200.3	3.3	(0.4)
	5,096.5	9.6	(9.8)

2)Derivatives held for hedging

	Group			Bank		
	Contractual/notional amount	Fair value Assets	Fair value Liabilities	Contractual/notional amount	Fair values Assets	Fair values Liabilities
Derivatives held for non-trading purposes for which hedge accounting has not been applied						
Interest rate swaps	263.5	1.3	(9.9)	203.5	0.8	(9.7)
Forward currency transactions	503.5	1.4	(1.5)	503.5	1.4	(1.5)
Total derivative assets/(liabilities) held for non trading	**767.0**	**2.7**	**(11.4)**	**707.0**	**2.2**	**(11.2)**
Total recognised derivative assets/(liabilities)		**12.3**	**(21.2)**		**12.5**	**(21.7)**
Non-recognised interest rate swaps held for non-trading	**2,313.5**	**16.5**	**(6.2)**	**2,313.5**	**16.5**	**(6.2)**
Total interest rate swaps held for non-trading	**2,577.0**	**17.8**	**(16.1)**	**2,517.0**	**17.3**	**(15.9)**

All amounts are stated in £m unless otherwise indicated

14. Derivative financial instruments (continued)

Maturity of Group over the counter interest rate related hedging transactions

		2004	
	Notional principal amount	**Fair value Assets**	**Fair value Liabilities**
1 year or less	589.0	2.4	(0.5)
1 to 5 years	1,755.9	15.4	(8.1)
Over 5 years	232.1	–	(7.5)
	2,577.0	**17.8**	**(16.1)**

All interest rate related transaction counterparties were financial institutions.

Exchange rate related transactions		2004	
	Total	**Financial institutions**	**Non-financial institutions**
Forward currency transactions	**503.5**	**494.1**	**9.4**

Maturity of over the counter exchange rate related transactions

		2004	
	Notional principal amount	**Fair value Assets**	**Fair value Liabilities**
One year or less	**503.5**	**1.4**	**(1.5)**

Hedges

As at 8 January 2005, hedge transactions were accounted for in accordance with the accounting treatment of the underlying transaction. Accordingly, hedge gains or losses may not be recognised at all in the financial statements.

The table below sets out the unrecognised gains and losses on hedges at 8 January 2005 and the movements during the year.

	Gains	**Losses**	**Net**
At 10 January 2004	**20.5**	**(4.9)**	**15.6**
Gains and losses arising in previous years that were recognised in the year ended 8 January 2005	**(10.6)**	**2.0**	**(8.6)**
Gains and losses arising before 10 January 2004 that were not recognised in the year ended 8 January 2005	**9.9**	**(2.9)**	**7.0**
Gains and losses arising in the year ended 8 January 2005 that were not recognised in the year ended 8 January 2005	**6.6**	**(3.3)**	**3.3**
At 8 January 2005	**16.5**	**(6.2)**	**10.3**
Of which			
8 January 2005			
Gains and losses expected to be recognised in the year ended 14 January 2006	**7.4**	**(2.3)**	**5.1**
Gains and losses expected to be recognised in the year ended 13 January 2007 or later	**9.1**	**(3.9)**	**5.2**

15. Equity shares

	Group and Bank	
	2005	2004
Investment securities – unlisted	**1.2**	1.2

Included above are the following trade investments		
BACS Limited **92,425** (2004 – 92,425) ordinary shares of £1 each	**0.7**	0.7
LINK Interchange Network Limited **3,845** (2004 – 3,845) ordinary shares of £1 each and **78,396** (2004 – 78,396) ordinary shares of £0.01 each.	**0.4**	0.4
	1.1	1.1

Equity Shares are classified as Available for sale.

All amounts are stated in £m unless otherwise indicated

16. Interest in associated undertakings and joint ventures

The interests in associated undertakings, all of which are incorporated in Great Britain and operate in England and none of which is quoted, are:

Joint Ventures	**Nature of business**	**Total issued share capital at 14 January 2006**	**Group interest 2005**	Group interest 2004
Ochil Residential Limited	Property development/ house building	2 Ordinary shares at £1 each	**50%**	50%
*Unity Financial Holdings Limited	Holding company	100 Ordinary shares of £1 each	**–**	13%
**Unity Pension Services	Marketing of pension plans	2 Ordinary shares of £1 each	**–**	13%
**Unity Financial Services Limited	Marketing of financial services	1,000,000 Ordinary shares of £1 each	**–**	13%
**Jacques Martin Unity Limited	Administration of pension schemes	1,000,000 Ordinary shares of £1 each	**–**	13%

*Unity Trust Bank p.l.c., held 50% of the ordinary share capital of this company.
**Unity Financial Holdings Limited held 100% of the ordinary share capital of this company.

The interest in associated undertakings and joint ventures is made up as follows:

	Share of gross assets	**Share of gross liabilities**	**Group Share of net assets**	**Bank Cost**
At 8 January 2005	0.2	–	0.2	–
At 14 January 2006	–	–	–	–

17. Intangible fixed assets

	Group and Bank Computer software **2005**	2004
Net book value		
At 8 January 2005	**8.3**	9.5
Additions	**1.5**	2.1
Disposals	**–**	–
Amortisation	**(3.2)**	(3.3)
At 14 January 2006	**6.6**	8.3

18. Property, plant and equipment

	Freehold and leasehold buildings	**Computer and other equipment**	**Total**
Group:			
Cost			
At 8 January 2005	**10.3**	**207.6**	**217.9**
Additions	**–**	**23.1**	**23.1**
Disposals	**–**	**(40.9)**	**(40.9)**
At 14 January 2006	**10.3**	**189.8**	**200.1**
Accumulated depreciation:			
At 8 January 2005	**2.5**	**129.7**	**132.2**
Disposals	**–**	**(39.7)**	**(39.7)**
Charge for the year	**0.3**	**21.2**	**21.5**
At 14 January 2006	**2.8**	**111.2**	**114.0**
Net book value at 14 January 2006	**7.5**	**78.6**	**86.1**
Net book value at 8 January 2005	7.8	77.9	85.7

All amounts are stated in £m unless otherwise indicated

18. Property, plant and equipment (continued)

	Freehold and leasehold buildings	Computer and other equipment	Total
Bank:			
Cost			
At 8 January 2005	**2.8**	**204.5**	**207.3**
Additions	**–**	**22.7**	**22.7**
Disposals	**–**	**(40.7)**	**(40.7)**
At 14 January 2006	**2.8**	**186.5**	**189.3**
Accumulated depreciation			
At 8 January 2005	**0.9**	**127.4**	**128.3**
Disposals	**–**	**(39.6)**	**(39.6)**
Charge for the year	**0.1**	**20.7**	**20.8**
At 14 January 2006	**1.0**	**108.5**	**109.5**
Net book value at 14 January 2006	**1.8**	**78.0**	**79.8**
Net book value at 8 January 2005	1.9	77.1	79.0

	Freehold and leasehold buildings	Computer and other equipment	Total
Group:			
Cost			
At 10 January 2004	10.3	192.9	203.2
Additions	–	22.8	22.8
Disposals	–	(8.1)	(8.1)
At 8 January 2005	10.3	207.6	217.9
Accumulated depreciation			
At 10 January 2004	2.2	118.6	120.8
Disposals	–	(8.0)	(8.0)
Charge for the year	0.3	19.1	19.4
At 8 January 2005	2.5	129.7	132.2
Net book value at 8 January 2005	7.8	77.9	85.7
Net book value at 10 January 2004	8.1	74.3	82.4
Bank:			
Cost			
At 10 January 2004	2.8	189.6	192.4
Additions	–	22.7	22.7
Disposals	–	(7.8)	(7.8)
At 8 January 2005	2.8	204.5	207.3
Accumulated depreciation			
At 10 January 2004	0.8	116.5	117.3
Disposals	–	(7.7)	(7.7)
Charge for the year	0.1	18.6	18.7
At 8 January 2005	0.9	127.4	128.3
Net book value at 8 January 2005	1.9	77.1	79.0
Net book value at 10 January 2004	2.0	73.1	75.1

All amounts are stated in £m unless otherwise indicated

18. Property, plant and equipment (continued)

	Group		Bank	
	2005	2004	**2005**	2004
The net book value of land and buildings comprises:				
Freehold	**7.5**	7.8	**1.8**	1.9
Short leasehold	**–**	–	**–**	–
	7.5	7.8	**1.8**	1.9

All land and buildings are occupied by the Group for its own activities.
Included within property, plant and equipment are finance leased assets. At 14 January 2006, the net book value of these assets was £nil (2004 – £nil).

19. Other assets

	Group		Bank	
	2005	2004	**2005**	2004
Unrealised gains on foreign exchange and interest rate contracts	**–**	15.9	**–**	15.7
Trade debtors	**6.4**	4.2	**6.4**	3.9
Other assets	**17.5**	9.3	**17.5**	9.3
	23.9	29.4	**23.9**	28.9

20. Deposits by banks

	Group		Bank	
	2005	2004	**2005**	2004
Items in course of collection	**7.1**	7.8	**6.9**	7.5
Deposits from other banks	**627.6**	647.2	**634.2**	659.4
	634.7	655.0	**641.1**	666.9
of which:				
Variable rate	**46.0**	57.4	**46.0**	57.4
Fixed rate	**588.7**	597.6	**595.1**	609.5

21. Customer accounts

	Group		Bank	
	2005	2004	**2005**	2004
Variable rate	**7,579.1**	6,773.5	**7,152.0**	6,453.3
Fixed rate	**1,239.7**	1,325.2	**1,239.7**	1,325.2
	8,818.8	8,098.7	**8,391.7**	7,778.5

22. Debt securities in issue

	Group		Bank	
	2005	2004	**2005**	2004
Bonds and medium term notes	**299.9**	299.8	**299.9**	299.8
Other debt securities in issue	**750.3**	471.9	**750.3**	471.9
	1,050.2	771.7	**1,050.2**	771.7

23. Other borrowed funds

	Group		Bank	
	2005	2004	**2005**	2004
£50,000,000 Fixed Rate Perpetual Subordinated Notes	**–**	50.0	**–**	50.0
£30,000,000 Subordinated Perpetual Floating Rate Notes	**30.0**	30.0	**30.0**	30.0
£100,000,000 Step Up Callable Subordinated Notes 2011	**100.0**	100.0	**100.0**	100.0
£150,000,000 Step Up Callable Subordinated Notes 2019	**150.0**	150.0	**150.0**	150.0
60,000,000 9.25% non-cumulative irredeemable preference shares of £1 each	**60.0**	–	**60.0**	–
Issue costs and discount	**(1.9)**	(2.4)	**(1.9)**	(2.4)
	338.1	327.6	**338.1**	327.6

The Group has not had any defaults of principal, interest or redemption amounts during the period on its borrowed funds (2004: Nil).

All amounts are stated in £m unless otherwise indicated

23. Other borrowed funds (continued)

Fixed Rate Perpetual Subordinated Notes

The notes were issued on 20 December 1995 at a discount of 0.723%

The notes were an unsecured obligation of the Bank and in the event of the winding up of the Bank, the claims of noteholders were subordinated in right of payment to the claims of depositors and other creditors of the Bank.

The notes carried an interest rate of 9.375% per annum to (but excluding) 21 December 2005. Interest was payable annually in arrears on 20 December each year.

The Bank redeemed all of the notes at their principal amount on 21 December 2005.

Subordinated Perpetual Floating Rate Notes

The notes were issued on 9 January 1998.

The notes are an unsecured obligation of the Bank and in the event of the winding up of the Bank, the claims of noteholders will be subordinated in right of payment to the claims of depositors and other creditors of the Bank.

The notes carry an annual interest rate of 1.18% above six months LIBOR up to (but excluding) 9 January 2008. Thereafter the notes carry an annual interest rate of 2.18% above six months LIBOR. Interest is payable half yearly in arrears on 9 January and 9 July each year.

The Bank may redeem all, but not less than all, of the notes at their principal amount on 9 January 2008 and thereafter on any following 9 January or 9 July.

Step Up Callable Subordinated Notes 2011

The notes were issued on 16 November 2000 at a discount of 0.472%.

The notes are an unsecured obligation of the Bank and in the event of the winding up of the Bank, the claims of noteholders will be subordinated in right of payment to the claims of depositors and other creditors of the Bank.

The notes carry an annual interest rate of 7.375% per annum to (but excluding) 16 November 2006, and thereafter the interest rate will be determined by reference to the gross redemption yield on the five year benchmark gilt, and a margin of 2.5%. Interest is payable half yearly in arrears on 16 May and 16 November.

The Bank may redeem all, but not less than all, of the notes at their principal amount on 16 November 2006.

Step Up Callable Subordinated Notes 2019

The notes were issued on 1 April 2004 at a discount of 0.946%.

The notes are an unsecured obligation of the Bank and in the event of the winding up of the Bank, the claims of noteholders will be subordinated in right of payment to the claims of depositors and other creditors of the Bank.

The notes carry an annual interest rate of 5.875% per annum to (but excluding) 2 April 2014, and thereafter the interest rate will be determined by reference to the gross redemption yield on the five year benchmark gilt, and a margin of 2.25%. Interest is payable annually in arrears on 2 April.

The Bank may redeem all, but not less than all, of the notes at their principal amount on 2 April 2014.

No early repayment, which includes the purchase of the notes or stock by the Group for cancellation, of any of the above subordinated liabilities can be made without the prior written agreement of the Financial Services Authority.

60,000,000 9.25% non-cumulative irredeemable preference shares of £1 each

The preference shares carry the right to a fixed non-cumulative preferential dividend on the capital for the time being paid up, at the rate of 9.25% per annum exclusive of any associated tax credit. The dividends are payable on 31 May and 30 November each year and take priority over dividends to any other class of share in the capital of the Bank.

On a return of capital on a winding-up, the assets of the Bank shall be applied in repaying the preference share capital in priority to any payments to the holders of any other class of shares in the capital of the Bank. The amount receivable by the holders of the preference shares shall be the greater of the capital paid up or the average quoted price during the three months immediately preceding the date of the notice convening the meeting to consider the resolution to wind-up.

The holders of the preference shares shall have the right to vote at a general meeting of the Bank only if and when, at the date of the notice convening the meeting, the dividend due to them has been in arrears for six months or more or if a resolution is to be proposed at the meeting abrogating or varying their rights or privileges or for the winding-up of the Bank or other return of capital and then only on that resolution.

24. Other liabilities

	Group		Bank	
	2005	2004	**2005**	2004
Unrealised losses on foreign exchange and interest rate contracts	**–**	4.7	**–**	4.2
Trade creditors	**110.0**	83.0	**108.9**	81.9
Dividends	**–**	1.4	**–**	0.6
	110.0	89.1	**108.9**	86.7

All amounts are stated in £m unless otherwise indicated

25. Provision for liabilities

	Group		Bank	
	2005	2004	**2005**	2004
At 8 January 2005	**6.9**	7.7	**6.0**	6.9
Utilised	**(1.0)**	(2.3)	**(0.8)**	(2.1)
Profit and loss charge	**0.2**	1.5	**–**	1.2
At 14 January 2006	**6.1**	6.9	**5.2**	6.0

The above provisions at 14 January 2006 include an estimate of future unavoidable lease payments and related costs for vacant properties not in use (Group – £4.4 million, Bank – £3.8 million) and an estimate of future payments to customers in compensation for loss suffered from past pension and investment advice (Group – £1.7 million, Bank – £1.4 million).
Payments under future unavoidable lease commitments, net of amounts receivable under sub-lettings, are due on leases terminating between 2006 and 2016. Payments relating to past pension and investment advice will be made as individual cases are settled. The amounts provided in respect of compensation are based on a case by case review of expected payment for each outstanding claim and an estimate of the number and value of future claims based on past experience.

26. Deferred tax

Deferred taxes are calculated on all temporary differences under the liability method using an effective tax rate of 30% (2004 – 30%).

The movement on the deferred tax accounts are as follows:

	Group		Bank	
	2005	2004	**2005**	2004
At 8 January 2005 – net deferred tax	**23.2**	33.1	**30.0**	41.7
On application of IAS39	**0.7**	–	**1.0**	–
Income statement charge	**(1.4)**	(1.7)	**(2.5)**	(2.0)
Charged to equity				
Transferred from subsidiaries	–	–	**–**	(1.7)
Pension fund deficit	**(5.7)**	(8.2)	**(5.6)**	(8.0)
Cash flow hedges	**(2.0)**	–	**(1.8)**	–
At 14 January 2006 – net deferred tax	**14.8**	23.2	**21.1**	30.0

Net deferred tax comprises:

Deferred tax asset	**27.6**	33.1	**27.0**	32.4
Deferred tax liability	**(12.8)**	(9.9)	**(5.9)**	(2.4)
	14.8	23.2	**21.1**	30.0

Deferred taxation				
Taxation deferred by timing differences in accordance with the basis of accounting set out in Accounting Policy (i)				
Other timing differences	**1.1**	6.1	**1.1**	5.8
Retirement benefit obligations	**27.6**	33.1	**27.0**	32.4
Capital allowances on fixed assets	**(7.8)**	(3.2)	**(7.4)**	(2.7)
Capital allowances on assets leased to customers	**(6.1)**	(12.8)	**0.4**	(5.5)
	14.8	23.2	**21.1**	30.0

The deferred tax charge in the income statement comprises the following temporary differences:

Other timing differences	**3.7**	0.8	**3.9**	1.0
Retirement benefit obligations	**(0.2)**	0.8	**(0.2)**	0.5
Capital allowances on fixed assets	**4.6**	0.3	**4.7**	0.3
Capital allowances on assets leased to customers	**(6.7)**	(0.2)	**(5.9)**	0.2
	1.4	**1.7**	**2.5**	**2.0**

Full provision has been made for all other potential liabilities to deferred taxation.

Deferred tax assets are recognised for tax loss carry-forwards only to the extent that realisation of the related tax benefit is probable.

All amounts are stated in £m unless otherwise indicated

27. Pensions

The Bank operates a funded pension scheme of the defined benefit type. This provides benefits based on final pensionable pay.
The assets of the scheme are held in a separate trustee administered fund.
The Bank also operates a small unfunded pension scheme. The pension charge is assessed in the same manner and using the same assumptions as the funded scheme.
The pension charge is assessed in accordance with the advice of a qualified actuary. The latest full actuarial valuation of the funded scheme was at 5 April 2003.
The actuarial valuation has been updated to 14 January 2006. The principal assumptions used to calculate the schemes' liabilities were:

	2005	2004
Expected return on scheme assets	**6.1%**	6.6%
Rate of increase of pensions in payment	**2.7%**	2.7%
Rate of increase in salaries	**4.2%**	4.2%
Discount rate	**4.6%**	5.1%

The assumptions used by the actuary are the best estimates chosen from a range of possible actuarial assumptions which, due to the timescale covered may not necessarily be borne out in practice. The fair value of the scheme's assets, which are not intended to be realised in the future, may be subject to significant change before they are realised.
All members retiring in normal health have been assumed to retire at age 60.

The values of the assets and liabilities of the schemes were:

	Group		**Bank**	
	2005	2004	**2005**	2004
Fair value of plan assets	**432.1**	345.7	**421.9**	337.8
Present value of funded obligations	**(520.8)**	(450.3)	**(508.5)**	(439.9)
	(88.7)	(104.6)	**(86.6)**	(102.1)
Present value of unfunded obligations	**(3.4)**	(5.8)	**(3.4)**	(5.8)
Surplus/(deficit) in the scheme	**(92.1)**	(110.4)	**(90.0)**	(107.9)
Related deferred tax asset	**27.6**	33.1	**27.0**	32.4
Net pension asset/(liability)	**(64.5)**	(77.3)	**(63.0)**	(75.5)
Analysis of amount charged to income statement				
Current service cost	**20.0**	22.4	**19.5**	21.9
Expected return on pension scheme assets	**(23.7)**	(20.8)	**(23.2)**	(20.3)
Interest on pension scheme liabilities	**24.1**	23.4	**23.6**	22.9
	20.4	25.0	**19.9**	24.5
Expected return on scheme assets	**23.7**	20.8	**23.2**	20.3
Actuarial gains	**51.8**	10.1	**50.4**	10.0
Actual return on scheme assets	**75.5**	30.9	**73.6**	30.3

Changes in the present value of the scheme liabilities are as follows:

	Group		**Bank**	
	2005	2004	**2005**	2004
Opening defined benefit liabilities	**456.1**	434.6	**445.7**	424.6
Current service cost	**20.0**	22.4	**19.5**	21.9
Interest on liabilities	**24.1**	23.4	**23.6**	22.9
Contributions by members	**1.8**	–	**1.7**	–
Actuarial losses/(gains)	**32.6**	(17.2)	**31.7**	(16.7)
Benefits paid	**(10.4)**	(7.1)	**(10.3)**	(7.0)
Closing defined benefit liabilities	**524.2**	456.1	**511.9**	445.7

All amounts are stated in £m unless otherwise indicated

27. Pensions (continued)

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

	Group		Bank	
	2005	2004	**2005**	2004
Opening fair value of scheme assets	**345.7**	289.7	**337.8**	283.0
Expected return on scheme assets	**23.7**	20.8	**23.2**	20.3
Actuarial gains	**51.8**	10.1	**50.4**	10.0
Contributions by the employer	**16.7**	32.2	**16.3**	31.5
Contributions by members	**1.8**	–	**1.7**	–
Benefits paid	**(7.6)**	(7.1)	**(7.5)**	(7.0)
Closing fair value of scheme assets	**432.1**	345.7	**421.9**	337.8

The main categories of scheme assets as a percentage of total scheme assets are as follows:

	2005 %	2004 %	**2005 %**	2004 %
UK equities	**34%**	35%	**34%**	35%
Overseas equities	**37%**	35%	**37%**	35%
UK bonds	**23%**	24%	**23%**	24%
Overseas bonds	**5%**	5%	**5%**	5%
Property	**–**	–	**–**	–
Cash	**1%**	1%	**1%**	1%

Amounts recognised in the statement of recognised income and expense:

	2005	2004	**2005**	2004
Actuarial gains/(losses) on scheme liabilities during period	**(32.6)**	17.2	**(31.7)**	16.7
Actuarial gains/(losses) on scheme assets during period	**51.8**	10.1	**50.4**	10.0
Total scheme gains/(losses) during period	**19.2**	27.3	**18.7**	26.7
Cumulative actuarial gains/(losses) on scheme liabilities	**(15.4)**	17.2	**(15.0)**	16.7
Cumulative actuarial gains/(losses) on scheme assets	**61.9**	10.1	**60.4**	10.0
Cumulative total scheme gains/(losses)	**46.5**	27.3	**45.4**	26.7

The amounts for the current period are as follows:

	2005	2004	**2005**	2004
Defined benefit obligation	**(524.2)**	(456.1)	**(511.9)**	(445.7)
Scheme assets	**432.1**	345.7	**421.9**	337.8
Surplus/(deficit)	**(92.1)**	(110.4)	**(90.0)**	(107.9)
Experience adjustment on scheme liabilities	**26.7**	30.7	**26.2**	30.0
Experience adjustment on scheme assets	**51.8**	10.1	**50.4**	10.0

The best estimate of contributions expected to be paid to the plan during 2006 is £13.6m.

The overall deficit within the defined benefit pension scheme of £92.1m is based on the accounting standard IAS19. The calculation on this basis is highly sensitive to movements in equity, corporate bond markets and other actuarial estimates. Broadly if those markets and estimates had moved in line with actuarial assumptions set at the beginning of the financial year for scheme assets and liabilities, then the scheme would have recorded a deficit of £111.3m. IAS19 calculations give a short term view of the funding position for accounting purposes. Those calculations are exposed to significant fluctuations and do not present a full picture of the long term funding position of the scheme in the context of volatile markets and changing mortality rates.

In common with the majority of other UK employers, the Co-operative Group faces increasing costs and risks in the provision of occupational pension schemes for its employees, including Executives. In view of this, a strategic review of employee pension provision was completed during 2005. The review covered pension arrangements for all employees, including Executives, in the Co-operative Group and its financial services subsidiaries, Co-operative Financial Services, Co-operative Insurance Society and the Bank.

As a consequence of this review, some significant changes to occupational pension arrangements will be implemented with effect from 6 April 2006, with the approval of the Trustees of the Co-operative Group Pension Fund, the CIS Employees' Pension Scheme and The Co-operative Bank Pension Scheme (the Existing Schemes).

All amounts are stated in £m unless otherwise indicated

27. Pensions (continued)

The key proposed changes are:-

- The Existing Schemes will transfer into a new pension scheme on 6 April 2006.
- The new scheme, the Co-operative Group Pension (Average Career Earnings) Scheme (PACE), will be available to all employees of the Trading Group and Financial Services businesses. It will provide pensions and other benefits based on Career Average Earnings, revalued for inflation, in respect of pensionable service from 6 April 2006.
- Executives and employees will be provided with benefits from PACE on the same terms.
- Accrued benefits under the Existing Schemes as at 5 April 2006 will continue to be linked to final pensionable salary at the Executive or employees' actual date of leaving or retirement, whichever earlier.
- PACE members will contribute 6% of their pensionable salary.

The PACE scheme will maintain a competitive level of pension provision whilst controlling the future cost and risks of occupational pension provision.

28. Share capital

	Group and Bank	
	2005	2004
Authorised:		
1,100,000,000 ordinary shares of 5p each	**55.0**	55.0
Issued:		
1,100,000,000 ordinary shares of 5p each	**55.0**	55.0
Share premium account	**8.8**	8.8
	63.8	63.8

All the issued share capital has been allotted, called up and fully paid. The shareholders have one vote for every share held.

29. Reserves and retained earnings

Movements in retained earnings were as follows	**Bank and subsidiary undertakings**	**Associated undertakings**	**Group**	**Bank**
Retained earnings at 10 January 2004	397.3	(1.1)	396.2	379.7
Net profit for year	81.0	–	81.0	78.7
Dividend	(15.0)	–	(15.0)	(15.0)
Retirement benefit schemes	18.7	–	18.7	18.7
Retained earnings at 8 January 2005	**482.0**	**(1.1)**	**480.9**	**462.1**
On application of IAS39	(10.6)	–	(10.6)	(10.5)
Net profit for year	63.2	–	63.2	60.9
Dividend	(18.8)	–	(18.8)	(18.8)
Retirement benefit schemes	13.2	–	13.2	13.1
Retained earnings at 14 January 2006	**529.0**	**(1.1)**	**527.9**	**506.8**

The cumulative amount of goodwill arising on the acquisition of subsidiary undertakings, net of goodwill attributed to subsidiary undertakings disposed of, is **£247,000** (2004 – £247,000).

	Group		Bank	
	2005	2004	**2005**	2004
Revaluation reserve – Available for sale investments	**4.0**	–	**4.0**	–
Hedging reserve – cash flow hedges	**8.0**	–	**7.9**	–
Other reserves	**12.0**	–	**11.9**	–

All amounts are stated in £m unless otherwise indicated

29. Reserves and retained earnings (continued)

	Group 2005	Group 2004	Bank 2005	Bank 2004
Revaluation reserve – Available for sale investments				
At 10 January 2004 and 8 January 2005	**–**	–	**–**	–
On application of IAS39	**6.8**	–	**6.8**	–
Tax on application of IAS39	**(2.0)**	–	**(2.0)**	–
	4.8	–	**4.8**	–
Net gains/(losses) from changes in fair value	**(0.1)**	–	**(0.1)**	–
Deferred income taxes	**–**	–	**–**	–
Net gains transferred to net profit on disposal	**(1.0)**	–	**(1.0)**	–
Deferred income taxes	**0.3**	–	**0.3**	–
At 14 January 2006	**4.0**	–	**4.0**	–

Hedging reserve – cash flow hedges

	2005	2004	2005	2004
At 10 January 2004 and 8 January 2005	**–**	–	**–**	–
On application of IAS39	**5.4**	–	**5.1**	–
Tax on application of IAS39	**(1.7)**	–	**(1.5)**	–
	3.7	–	**3.6**	–
Gains/(losses) from changes in fair value	**6.1**	–	**6.1**	–
Deferred taxes	**(1.8)**	–	**(1.8)**	–
Transferred to net profit	**–**	–	**–**	–
Deferred taxes	**–**	–	**–**	–
Balance at 14 January 2006	**8.0**	–	**7.9**	–

Dividends

After the balance sheet date the following dividends were proposed by the directors. The dividends have not been provided for and there are no income tax consequences.

	2005	2004
Nil per ordinary share (2004: 0.45p)	**–**	5.0

30. Statement of changes in equity

	Group 2005	Group 2004	Bank 2005	Bank 2004
Equity at beginning of year	**624.8**	538.5	**585.9**	503.5
Application of IAS32 and IAS39:				
Reclassification of preference shares	**(60.0)**	–	**(60.0)**	–
Income recognition	**2.6**	–	**2.6**	–
Debt impairment	**(9.3)**	–	**(9.5)**	–
Mark to market changes	**7.3**	–	**7.1**	–
Other	**(2.3)**	–	**(2.3)**	–
Beginning of year (restated)	**563.1**	538.5	**523.8**	503.5
Total recognised income and expense for the year	**82.6**	107.7	**77.5**	102.9
Dividend – equity shareholders	**(18.8)**	(15.0)	**(18.8)**	(15.0)
Dividend – minority interests	**(0.3)**	(0.9)	**–**	–
Dividend – preference shareholders	**–**	(5.5)	**–**	(5.5)
Equity at end of year	**626.6**	624.8	**582.5**	585.9

All amounts are stated in £m unless otherwise indicated

31. Contingent liabilities and commitments

The tables below give, for the Group and the Bank, the nominal principal amounts, credit equivalent amounts and risk weighted amounts of contingent liabilities and commitments. The nominal principal amounts indicate the volume of business outstanding at the balance sheet date and do not represent amounts at risk. The credit equivalent and risk weighted amounts have been calculated in accordance with the FSA guidelines implementing the Solvency Ratio Directive on capital adequacy.

	2005				2004	
	Contract amount	**Credit equivalent amount (i)**	**Average risk weight**	**Risk weighted amount**	Contract amount	Risk weighted amount
Group:						
Contingent Liabilities:						
– Acceptances and endorsements	**–**	**–**	**–**	**–**	37.5	37.5
– Guarantees and irrevocable letters of credit	**83.5**	**68.2**	**96.5%**	**65.8**	66.9	53.6
	83.5			**65.8**	104.4	91.1
Bank:						
Contingent Liabilities:						
– Acceptances and endorsements	**–**	**–**	**–**	**–**	37.5	37.5
– Guarantees and irrevocable letters of credit	**79.3**	**66.1**	**96.4%**	**63.7**	66.1	53.2
	79.3			**63.7**	103.6	90.7
Group:						
Other commitments:						
– Documentary credits and short-term trade-related transactions	**0.9**	**0.2**	**100.0%**	**0.2**	1.6	0.3
Undrawn formal standby facilities, credit lines and other commitments to lend:						
– 1 year and over	**345.0**	**172.5**	**99.7%**	**171.9**	379.1	187.8
– less than 1 year (ii)	**5,698.4**	**–**	**–**	**–**	5,876.8	–
	6,044.3			**172.1**	6,257.5	188.1
Bank:						
Other commitments:						
– Documentary credits and short-term trade-related transactions	**0.9**	**0.2**	**100.0%**	**0.2**	1.6	0.3
Undrawn formal standby facilities, credit lines and other commitments to lend:						
– 1 year and over	**345.0**	**172.5**	**99.7%**	**171.9**	379.1	187.8
– less than 1 year (ii)	**5,686.8**	**–**	**–**	**–**	5,865.0	–
	6,032.7			**172.1**	6,245.7	188.1

Notes:
(i) Under the Solvency Ratio Directive, credit equivalent amounts, obtained by applying credit conversion factors, are risk weighted according to counterparty.
(ii) Undrawn loan commitments which are unconditionally cancellable at any time or which have a maturity of less than one year have a risk weighting of zero. This item consists largely of undrawn credit card facilities.

Assets pledged

Assets are pledged as collateral under repurchase agreements with other banks.
Mandatory reserve deposits are also held with the Bank of England in accordance with statutory requirements.
These deposits are not available to finance the Group's day-to-day operations.

	Asset		**Related liability**	
	2005	2004	**2005**	2004
Balances with central banks	**9.9**	9.6	**–**	–
Investment securities	**–**	–	**–**	–
	9.9	9.6	**–**	–

All amounts are stated in £m unless otherwise indicated

31. Contingent liabilities and commitments (continued)

Operating lease commitments

	2005 Land and buildings	**2005 Motor vehicles**	2004 Land and buildings	2004 Motor vehicles
At the year end, the future minimum lease payments under non-cancellable operating leases were:				
– Group:				
– Expiring:				
– within one year	0.5	–	0.6	0.1
– between one and five years	5.7	–	6.2	–
– in five years or more	105.6	–	87.6	–
	111.8	**–**	**94.4**	**0.1**
– Bank:				
– Expiring:				
– within one year	**0.5**	**–**	0.6	0.1
– between one and five years	**5.5**	**–**	5.9	–
– in five years or more	**109.9**	**–**	95.5	–
	115.9	**–**	102.0	0.1

32. Related party transactions

Co-operative Financial Services Limited owns 100% of the issued ordinary share capital of the Bank and is the Bank's immediate holding company. Co-operative Financial Services Limited is incorporated in Great Britain and is registered under the Industrial and Provident Societies Acts 1965 to 1978. The ultimate holding organisation is the Co-operative Group (CWS) Limited, which is incorporated in Great Britain and is registered under the Industrial and Provident Societies Acts 1965 to 1978. The financial statements of the immediate and ultimate holding organisations are available from New Century House, Manchester M60 4ES. The principal operating subsidiaries of The Co-operative Bank p.l.c., all of which are incorporated in Great Britain and operate in England, and none of which are quoted, are:

Operating subsidiaries	**Nature of business**	**Total issued share capital at 14 January 2006**	**Group interest 2005**	Group interest 2004
* Unity Trust Bank p.l.c.	Banking	16,428,460 Ordinary shares of £1 each	**27%**	27%
Co-operative Commercial Limited	Investment company	1,000,000 Ordinary shares of £1 each	**100%**	100%
Roodhill Leasing Limited	Leasing	2 Ordinary shares of £1 each	**100%**	100%
First Roodhill Leasing Limited	Leasing	100 Ordinary shares of £1 each	**100%**	100%
Second Roodhill Leasing Limited	Leasing	100 Ordinary shares of £1 each	**100%**	100%
Third Roodhill Leasing Limited	Leasing	100 Ordinary shares of £1 each	**100%**	100%
Fourth Roodhill Leasing Limited	Leasing	100 Ordinary shares of £1 each	**100%**	100%
First Pioneers Leasing Limited	Leasing	100 Ordinary shares of £1 each	**100%**	100%
Second Pioneers Leasing Limited	Leasing	100 Ordinary shares of £1 each	**100%**	100%
Third Pioneers Leasing Limited	Leasing	100 Ordinary shares of £1 each	**100%**	100%
Co-operative Bank Financial Advisers Limited	Financial advisers	100,000 Ordinary shares of £1 each	**100%**	100%

* Held through subsidiary undertaking

Shares in Group undertakings:

	Cost	**Bank Provision**	**Carrying value**
At 14 January 2006	**3.1**	**(0.4)**	**2.7**
At 8 January 2005	**1.6**	**(0.4)**	**1.2**

The above provision is held against dormant subsidiaries.

All amounts are stated in £m unless otherwise indicated

32. Related party transactions (continued)

Details of all Group companies will be annexed to the Bank's next annual return.

Unity Trust Bank p.l.c. is considered to be a subsidiary undertaking of The Co-operative Bank p.l.c. as The Co-operative Bank p.l.c. elects a majority of the Directors and appoints the Chair and Managing Director of Unity Trust Bank p.l.c.

The financial statements of the above undertaking are consolidated into the Group financial statements.

The following undertakings have year ends which are not co-terminous with that of The Co-operative Bank p.l.c. to enable competitive leasing quotations to be offered throughout the year:

31 March	First Pioneers Leasing Limited
30 June	Second Pioneers Leasing Limited
30 September	Third Pioneers Leasing Limited

The financial statements of these undertakings are consolidated into the Group financial statements on the basis of management accounts made up to the parent undertaking's balance sheet date.

A number of banking transactions are entered into with related parties in the normal course of business on normal commercial terms. These include loans and deposits. Key management are considered to be Board and Executive members of the Group and Board and Executives of the Group's immediate and ultimate holding organisations. The volume of related-party transactions, outstanding balances at the year end, and related income and expense for the year are as follows:

	Group and Bank Directors and key management personnel	
	2005	2004
Loans outstanding at 8 January 2005	**1.0**	0.8
Interest and fee income earned	**–**	–
Net movement	**0.8**	0.2
Loans outstanding at 14 January 2006	**1.8**	1.0
Deposits at 8 January 2005	**1.4**	1.7
Interest and fee expense	**0.2**	0.1
Net movement	**2.7**	(0.4)
Deposits at 14 January 2005	**4.3**	1.4

	Associated companies			
	Group		Bank	
	2005	2004	**2005**	2004
Loans at 8 January 2005	**16.5**	8.3	**68.9**	89.5
Interest and fee income earned	**2.9**	4.0	**4.8**	6.6
Net movement	**(19.1)**	4.2	**(32.8)**	(27.2)
Loans at 14 January 2006	**0.3**	16.5	**40.9**	68.9
Deposits at 8 January 2005	**73.7**	80.5	**87.1**	84.2
Interest and fee income earned	**(1.2)**	(1.7)	**(1.2)**	(1.7)
Interest and fee income paid	**3.4**	4.2	**3.4**	2.6
Net movement	**78.8**	(9.3)	**72.4**	2.0
Deposits at 14 January 2005	**154.7**	73.7	**161.7**	87.1
Loans to customers include:				
Due from subsidiary undertakings	**–**	–	**40.6**	52.4
Due from parent undertakings	**–**	10.2	**–**	10.2
Due from fellow subsidiary undertakings	**0.3**	6.3	**0.3**	6.3

All amounts are stated in £m unless otherwise indicated

32. Related party transactions (continued)

	Associated companies			
	Group		Bank	
	2005	2004	**2005**	2004
Deposits by banks include:				
Due to subsidiary undertakings	**–**	–	**6.6**	12.2
Customer accounts include: Due to subsidiary undertakings	**–**	–	**0.4**	1.6
Due to parent undertakings	**92.3**	1.7	**92.3**	1.7
Due to fellow subsidiary undertakings	**43.8**	52.3	**43.8**	52.3
Due to associated undertakings	**–**	0.4	**–**	–

Key management compensation

	Group and Bank	
	2005	2004
Salaries and other short term benefits	**6.3**	3.5
Termination benefits	**1.1**	–
	7.4	3.5

Directors remuneration

A listing of the members of the Board of Directors is shown on page 28.
In 2005, the total remuneration of the Directors was £4.8m.

Reconciliation of 2004 income statement from UK GAAP to Proforma IFRS presentation

All amounts are stated in £m unless otherwise indicated

	UK GAAP	IAS19 Pension costs	IAS17 Lease income	Statutory basis	IAS39* Effective interest rate	IAS39* Bad debt provisions	IAS39* Valuation changes	IAS32* Classification changes	Proforma* basis
Interest and similar income	**592.5**	–	0.1	**592.6**	1.3	2.0	(1.1)	(1.5)	**593.3**
Interest expense and similar charges	**(267.6)**	–	–	**(267.6)**	(1.9)	–	(0.3)	(5.5)	**(275.3)**
Net Interest Income	**324.9**	**–**	**0.1**	**325.0**	**(0.6)**	**2.0**	**(1.4)**	**(7.0)**	**318.0**
Fee and commission income	**229.4**	–	–	**229.4**	(8.0)	–	–	–	**221.4**
Fee and commission expense	**(49.7)**	–	–	**(49.7)**	9.1	–	–	–	**(40.6)**
Net fee and commission income	**179.7**	**–**	–	**179.7**	**1.1**	**–**	**–**	**–**	**180.8**
Dividend income	**0.3**	–	–	**0.3**	–	–	–	–	**0.3**
Net trading income	**4.1**	–	–	**4.1**	–	–	–	1.5	**5.6**
Operating income	**509.0**	**–**	**0.1**	**509.1**	**0.5**	**2.0**	**(1.4)**	**(5.5)**	**504.7**
Operating expenses	**(314.2)**	(5.5)	–	**(319.7)**	–	–	–	–	**(319.7)**
Profit before impairment losses	**194.8**	**(5.5)**	**0.1**	**189.4**	**0.5**	**2.0**	**(1.4)**	**(5.5)**	**185.0**
Impairment losses on loans and advances	**(62.8)**	–	–	**(62.8)**	–	(7.9)	–	–	**(70.7)**
Profit before taxation	**132.0**	**(5.5)**	**0.1**	**126.6**	**0.5**	**(5.9)**	**(1.4)**	**(5.5)**	**114.3**
Income tax expense	**(39.6)**	1.6	–	**(38.0)**	(0.1)	1.7	0.4	–	**(36.0)**
Profit for the period	**92.4**	**(3.9)**	**0.1**	**88.6**	**0.4**	**(4.2)**	**(1.0)**	**(5.5)**	**78.3**
Minority interests	**(2.2)**	0.1	–	**(2.1)**	–	–	–	–	**(2.1)**
Net profit	**90.2**	**(3.8)**	**0.1**	**86.5**	**0.4**	**(4.2)**	**(1.0)**	**(5.5)**	**76.2**
Preference dividend to non-equity shareholders	**(5.5)**	–	–	**(5.5)**	–	–	–	5.5	–
Profit attributable to equity shareholders	**84.7**	**(3.8)**	**0.1**	**81.0**	**0.4**	**(4.2)**	**(1.0)**	**–**	**76.2**

***Unaudited**

NOTICE IS HEREBY GIVEN that the Annual General Meeting of The Co-operative Bank p.l.c will be held at the Board Room, 24th floor, CIS Building, Miller Street, Manchester M60 0AL, on Wednesday 10 May 2006 at 10 am for the following purposes:

1. To receive the Notice convening the meeting.
2. To receive the Annual Reports and adopt the Financial Statements for the year ended 14 January 2006 together with the Auditor's Report.
3. To approve the Remuneration Report for the year ended 14 January 2006.
4. To accept the following recommendations of the Board in respect of the Non-cumulative Irredeemable Preference Shares:
   (i) that the payment of the dividend of 4.625p per £1 share on 30 November 2005 be confirmed.
   (ii) that a dividend of 4.625p per £1 share be declared and paid on 31 May 2006 to the registered holders as at 28 April 2006 providing a dividend rate of 9.25 per cent per annum and making a total distribution of £5,550,000.
5. To accept the following recommendations of the Board in respect of the Ordinary Shares:
   (i) that the payment of the interim dividend of £13.75 million paid on 30 September 2005 be confirmed.
6. (a) To re-elect the following Directors who retire by rotation, in accordance with the provisions of Article 105:
   (i) Simon Butler, Non-Executive Director, Chair of CIS;
   (ii) Graham Stow, Independent Professional Non-Executive Director;
   (iii) Martin Beaumont, Non-Executive Director, Chief Executive of the Co-operative Group;
   (iv) Kathryn Smith, Non-Executive Director.

   (b) To re-elect the following Directors who were appointed since the date of the last Annual General Meeting, in accordance with the provisions of Article 111:
   (i) David Anderson, Executive Director and Chief Executive;
   (ii) Piers Williamson, Independent Professional Non-Executive Director;
   (iii) Terry Morton, Non-Executive Director;
   (iv) Stephan Pater, Executive Director;
   (v) Len Wardle, Non-Executive Director;
   (vi) Stephen Watts, Non-Executive Director.
7. That KPMG Audit Plc be and are hereby re-appointed auditor of the Company, to hold office from the conclusion of this meeting until the conclusion of the next General Meeting at which accounts are laid before the Company, at a remuneration to be fixed by the Directors.

Registered Office:
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Reg. No. 990937 (England)
Tel : 0161 832 3456
Fax : 0161 829 4475

Registrar:
Computershare Investor Services PLC
P.O. Box 82
The Pavilions
Bridgwater Road
Bristol BS99 7NH
Tel: 0870 702 0003

By Order of the Board
Moira Lees,
Secretary
6 April 2006

A member entitled to attend and vote at the Meeting is entitled to appoint a proxy to attend and vote on his/her behalf. A proxy need not also be a member. Further information on Preference Shareholders' voting rights is given below.

Members should note that to attend the meeting their shareholding must be registered on the register of the Company not later than 5.00pm on 26 April 2006. This applies to shares held in uncertified forms in CREST and to shares held in certified form.

Notes:

1. Director Information

The biographies of the Directors up for re-election and re-appointment at the Annual General Meeting can be found on page 28 of the Report and Financial Statements.

2. Preference Shareholders – Extract from Articles of Association 4 (B)(c)

Voting and General Meetings

(i) The holders of the Preference Shares shall be entitled to receive notice of and attend (either in person or by proxy) all General Meetings of the Company. The holders of the Preference Shareholders' shall have a right to speak and vote at a General Meeting of the Company only if and when, at the date of the notice convening such meeting, the fixed preferential dividend payable to them respectively has been in arrears for six months or more after any date fixed for payment thereof, or if a resolution is to be proposed at such meeting abrogating or varying any of the respective rights or privileges attaching to their shareholding or for the winding-up of the Company or other return of capital and then on such resolution only.

(ii) Whenever the holders of the Preference Shares are entitled to vote at a General meeting of the Company upon any resolution proposed at such meeting, on a show of hands every holder who (being an individual) is present in person or (being a corporation) is present by a representative or by proxy shall have one vote and, on a poll, shall have one vote in respect of each Preference Share registered in the name of such holder.

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