The **co-operative** bank
good with money

The Co-operative Bank p.l.c.
Stability, support and security in the community

Financial statements 2008

In a challenging market we have provided **stability, support and security** for all our local, global and business

Contents

Our unique **vision, values and achievements** mean that we have a reputation of success. But more importantly, these foundations mean we are someone you can

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 **vision**

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

As a co-operative business, these are **our values**

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 The Co-operative Financial Services 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 The Co-operative Financial Services and know we can contribute to making it a great place to work.

Performance

The Co-operative Bank achieved an operating profit before tax, Financial Services Compensation Scheme (FSCS) levy and significant items of £85.6m compared with £50.4m in 2007. Profit before tax was £23.3m (2007: £11.1m).

The ratio of customer deposits to customer loans remains strong at 107% (2007: 104%).

We saw strong sales performance in the Retail sector, including growth in mortgages, current accounts and personal savings.

Our Corporate Banking sector has also experienced strong growth in operating income driven by higher lending and deposit balances.

Achievements

- The Co-operative Bank won 'Best Remortgage' at the 2008 Moneywise Mortgage Awards.
- The Co-operative Bank took 'Best First-Time Buyer' at the 2008 Moneywise Mortgage Awards.
- The Co-operative Bank was awarded 'highly commended' for 'Best flexible mortgage' at the 2008 Moneywise Mortgage Awards.
- **smile** was voted second for customer satisfaction in a BBC Watchdog consumer survey.
- The Co-operative Bank took third place for customer satisfaction in a BBC Watchdog consumer survey.
- **smile** was voted as 'Best buy current account provider' by Which?, scoring very highly on overall customer satisfaction.
- The People's Choice report from Which? also awarded **smile** the highest customer satisfaction score for current accounts.
- The Co-operative Bank received a 'Gold Award' at the lending Excellence Awards for service quality, speed, transparency and communications.
- The Co-operative Bank was named as the 'Best Customer Service provider' by leading research company, JD Power and Associates.
- The Co-operative Bank picked up 'Best Brand for Financial Services' at the 2008 Top 100 North West Brands event.
- The Co-operative Bank hit the £4bn mark for personal savings for the first time in its history.
- Our Corporate Banking deposit balances have increased by 27% in 2008 following a concerted campaign.
- We opened six new Corporate Banking Centres in 2008.
- In April 2008, we launched two re-priced corporate liability products; Corporate Treasury Account and a Guaranteed Investment Account.
- The Co-operative Bank launched its Current Account Plus combining a current account with a linked savings product.
- The Co-operative Bank took third place and was the highest ranking financial services company in the Sunday Times Best Green Companies Awards.
- The Co-operative Bank was ranked 7th in the UK Ethical Reputation Index. Rated the highest financial institution in the index, improving from 8th place in 2007.
- The Co-operative Bank was instrumental in ensuring our parent, The Co-operative Financial Services, took the prestigious Financial Innovation Award for the 'Best Corporate Social Responsibility Programme', specifically for demonstrating social inclusion across many areas.
- The Co-operative Bank made a major contribution to our parent, The Co-operative Financial Services, being named 'Company of the Year' at the Business in the Community (BitC) awards.

A few words from Graham Bennett in our
chair's statement.

We are not immune to the challenges that face all financial services institutions, but our responsible approach to banking has enabled us to produce a solid performance.

Despite the upheaval in financial markets which has hit the whole of the banking industry, The Co-operative Bank has produced a strong set of financial results in 2008.

We are not immune to the challenges that face all financial services institutions, but our responsible approach to banking has enabled us to produce a solid performance with operating profits of £85.6m before tax, Financial Services Compensation Scheme (FSCS) levy and significant items in 2008 compared to £50.4m in 2007.

Our approach to executive remuneration (detailed in the remuneration report) has not encouraged excessive risk-taking but rather supports the long term strength and sustainability of our business.

I mentioned in last year's Financial Statements our progress towards our new common identity, and in April 2008 we launched 'The Co-operative' brand. Bringing the different businesses across The Co-operative Financial Services Group closer together makes it easier for our customers to recognise the comprehensive range of benefits and services available to them.

Our Ethical Policy, which celebrated its sixteenth year, is integral to our brand and heritage, and that's why during the second half of 2008 we invited our customers to provide their views on their social, ethical and environmental concerns. This has culminated in a new Ethical Policy being launched which brings our actions right up to date with public thinking.

In addition, The Co-operative Bank has received a host of awards, as you can see on page 3. These achievements clearly demonstrate our continued commitment to our customers in all channels from face-to-face communication in our branches, to our contact centres and online.

During 2008 we opened six new Corporate Banking Centres in Altrincham, Southampton, Chelmsford, Edinburgh, Cambridge and Glasgow. We have now doubled the number of centres across the country since late 2006.

In early 2009 the Board approved plans to merge with Britannia Building Society, which if the vote of the Society's members is successful will significantly broaden our customer base and our product, service and distribution capabilities.

2008 has been a year of continued stability and consolidation for The Co-operative Bank against a very difficult backdrop. The challenges are sure to continue in 2009, but I am confident we are well equipped to meet them and our strong business model and co-operative values will stand us in good stead.

I would like to take this opportunity to thank Stephan Pater, Chief Operating Officer, and Gerry Pennell, Executive Director Business Transformation and Shared Services who left the business during 2008. I would also like to welcome Dick Parkhouse, Managing Director Retail and Barry Tootell, Chief Financial Officer who joined the Board in 2008.

Graham Bennett
Chair

The **Chief Executive's overview** from our Chief Executive David Anderson.

Our financial strength and the responsible approach we have historically taken in managing our customers' money is helping to build consumer confidence in our brand during uncertain times.

2008 was a very challenging year for The Co-operative Bank but we emerged from it in good shape. The Co-operative Bank has largely avoided the consequences of the market turmoil. Our cautious and responsible approach to business development limited our exposure to the problems that have afflicted many in the sector. Our liquidity ratio is strong and the savings balances we have attracted from our retail and corporate customers are higher than the balances we lent to our customers. This has helped to reduce our exposure to the risks of heavy financing from other banks or wholesale markets.

An operating profit for 2008 before tax, Financial Services Compensation Scheme (FSCS) levy and significant items of £85.6m was recorded compared with £50.4m in 2007.

We saw strong sales performance in the Retail sector, including growth in mortgages, current accounts and personal savings.

Our Corporate Banking sector has also experienced strong growth in operating income driven by higher lending and deposit balances.

Despite the environment, bad debt levels reduced by £5.2m compared to 2007, as a result of actions taken to increase our focus on secured lending, and implement initiatives to work with our customers much earlier where they are showing signs of financial difficulty.

The recent, unprecedented upheaval in the banking industry has led many customers to reconsider what they want from a bank. And as the focus shifts to financial stability and traditional values, The Co-operative Bank has seen a 61% increase in customers switching current accounts to us from the 'Big Four' banks. Our financial strength and the responsible approach we have historically taken in managing our customers' money is helping to build consumer confidence in our brand during uncertain times.

It's been a progressive year for The Co-operative Bank. The launch of 'The Co-operative' brand was an exciting step for us. Providing our customers with outstanding service and meeting their financial needs, whilst at the same time trying to make the world a fairer place for everyone seems more relevant now than ever before. Following our re-brand, The Co-operative Bank picked up the 'Best Financial Services' brand at the 2008 Top 100 North West Brands Awards.

A great example of how our new 'masterbrand' is helping The Co-operative family work together to mutual advantage was the launch of a new 'in-store' banking pilot. Four retail stores have had self service banking facilities installed which aim to help our Retail Banking sector provide a better service to existing customers, while at the same time reaching out to new ones. These new facilities offer automated self-service banking for customers, such as cash withdrawals and cash and cheque deposits. There are also touch screens providing product information, with sales assistants in the larger stores able to offer more information. We will assess the pilot with a view to rolling out based on experience of what is successful.

At a time of economic turbulence and uncertainty, The Co-operative Bank continues to strengthen its global position as a leader in social responsibility. In 2008, we sought a fresh mandate from our Co-operative Bank customers with regards to our unique ethical policy to ensure it reflects contemporary attitudes and opinion. Following a customer vote with over 80,000 responses, we will now decline finance for fuels with particularly high global warming potential, cluster bombs or activities that involve the exploitation of great apes. We've also renewed our commitment to a £400m fund to support positive green finance and a £25m fund to support microfinance.

We are continuing on our journey towards our vision of becoming the UK's most admired financial services business, making sure the products and services we offer to our customers are good value, fair and socially responsible. That's why this year we launched a new current account – Current Account Plus combining a current account with a linked savings product. An important step for us in demonstrating our move towards a relationship approach with our customers.

In addition, we've also launched the first packaged current account in the UK to offer customers an opportunity to choose benefits to suit their personal needs. This moves current accounts onto a new level by allowing consumers to tailor benefits to their lifestyle.

In April of this year we launched our Ownhome product, a Government backed scheme supported by a collaborative partnership between The Co-operative Bank and Places For People. The product allows a widening of home ownership and increased housing affordability for eligible key-workers, first time buyers and social housing tenants. Its launch reaffirmed our commitment to our ethical and social responsibility policy within the mortgage market and clearly shows our intention to be innovative in the process.

Also we launched an exclusive market-leading fee free three-year tracker mortgage. In the current economic climate, this new mortgage rewards our current account customers with a market-leading rate and the added benefit of no application fees.

Our focus on the customer is demonstrated by continuing high levels of satisfaction for our business relative to peer group. In September 2008, The Co-operative Bank was ranked highest in customer satisfaction according to the highly regarded JD Power and Associates 2008 UK Retail Banking Customer Satisfaction Study.

The Co-operative Bank and **smile** were also amongst the leaders when readers of Which? magazine and viewers of BBC Watchdog were asked to rate their banks for satisfaction. These findings clearly demonstrate our continued commitment to our customers in all channels from face-to-face communication in our branches, to our contact centres and online.

We've also started to make progress towards introducing a new 'Enterprise Platform', a key enabler to becoming truly customer-focused. The new platform will replace our Retail and Corporate Banking IT platforms and infrastructure with a new, state of the art, core banking platform. In doing so this will give us the opportunity to re-engineer our customer-facing and internal processes and to join them up with our General Insurance and Life & Savings systems so we can be truly customer centric.

In addition we've made headway in setting up our ability to send and receive 'Faster Payments'. The Co-operative Bank is part of the industry-wide Faster Payments programme. The programme is good news for consumers as they will gain the benefit of a faster electronic transfer of funds between accounts which will be processed in seconds.

Our Corporate Banking business has also made great progress. The new centres opened in 2008 enable us to grow our corporate relationship customer base in business communities within which we have not previously operated. We now have 20 centres across the country.

The Co-operative Bank also continued its focus on financial inclusion, which resonates very clearly with our co-operative values. We aim to play our part in making financial services available to those who can't easily access credit and other mainstream services. For individuals, we do this through our basic banking Cashminder account. And for businesses and social enterprises, we are the largest provider of banking facilities to the credit union movement in the UK, and a significant provider of finance to microfinance initiatives globally. We have contributed by opening significantly more than our share of basic bank accounts. Indeed, our pioneering work on opening bank accounts for prisoners in 2008 has been recognised in a report by Liverpool John Moores University which urges other banks to follow the lead set by The Co-operative.

In addition to this recognition, The Co-operative Bank collected a number of awards in 2008. In May, The Co-operative Bank won 'Best Remortgage' and 'Best First-Time Buyer' at the 2008 Moneywise Mortgage awards. We also received a 'Gold Award' at the Lending Excellence Awards for service, quality, speed, transparency and communications. Plus,

smile was voted as 'Best buy current account provider' by Which?, scoring 'very highly' on overall customer satisfaction.

Our parent, The Co-operative Financial Services, was awarded the title of 'Company of the Year' by Business in the Community, the premier organisation in socially responsible business.

Early in 2009 The Co-operative Bank announced its intentions to merge with Britannia Building Society, subject to a positive vote by the society's members at the end of April. This is an exciting development combining two strong organisations to create a powerful new mutual force in financial services. The transaction is planned for completion at the end of July 2009.

We've certainly made great progress in 2008 towards our vision to become the UK's most admired financial services business. Against a backdrop of difficult external forces, our responsible and sustainable approach to business has ensured we've remained a strong contender in the marketplace.

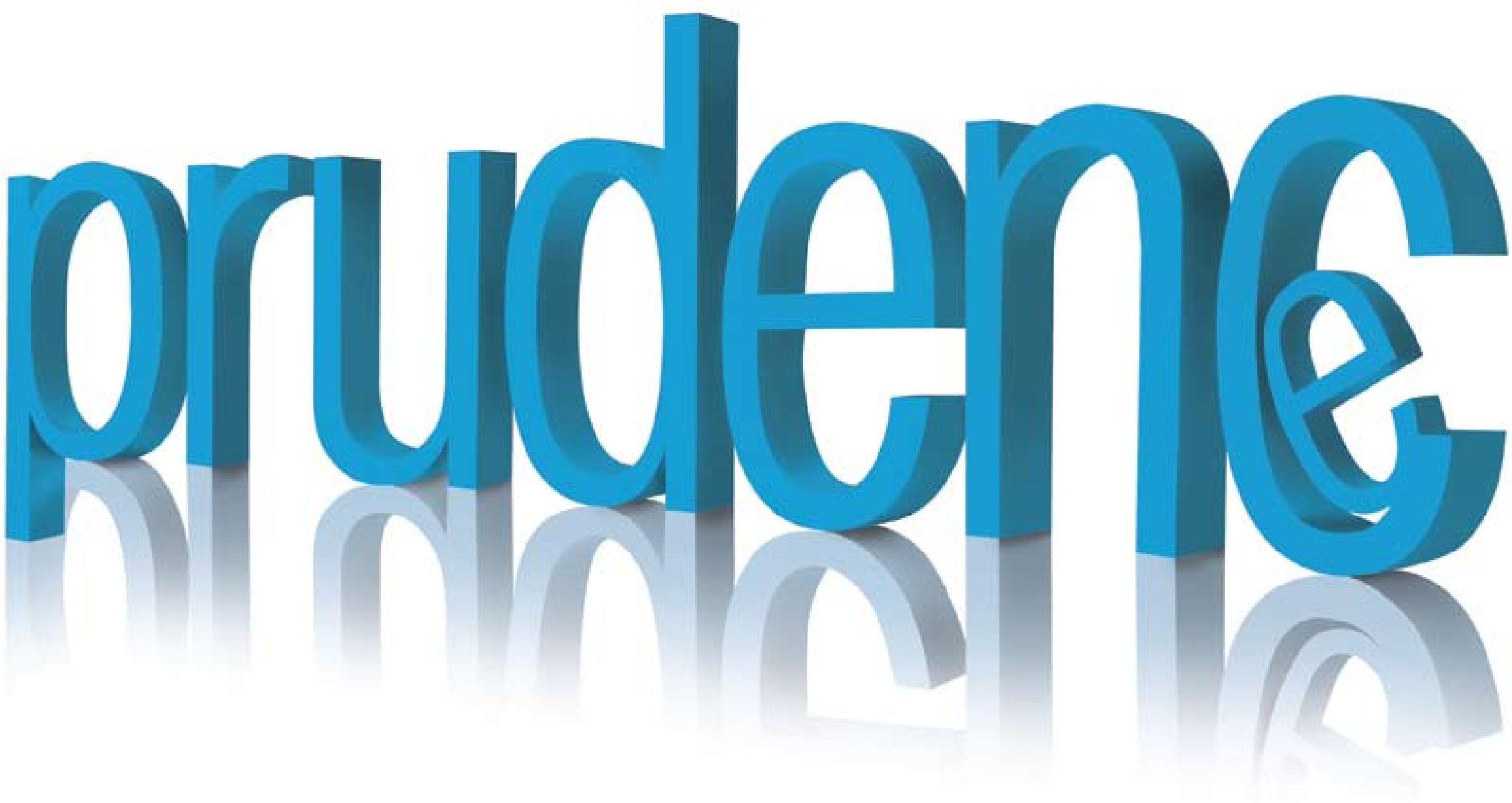
The establishment of a new bank assurance sales force in our branch network will be an exciting development in 2009. The sales force will be solely based in the branch and will focus on driving growth by making insurance products and financial planning solutions available to The Co-operative Bank customers.

The challenges are sure to continue in 2009, but I'm confident that our well-balanced approach to growth will continue to stand us in good stead.

David Anderson

David Anderson
Chief Executive

Our **business and financial review** shows a strong balance sheet because we manage our customers' finances with



Results summary

Operating profit before tax, Financial Services Compensation Scheme (FSCS) levy and significant items increased by £35.2m (69.8%) to £85.6m as strong balance sheet growth was achieved in both lending and deposit balances resulting in higher non and net interest income. Bad debt and operating costs have also improved on 2007. Despite investment write downs in the wholesale business, we believe these results are creditable in the current market conditions. They reflect the Bank's policy of funding lending from customer deposits, and a cautious approach to lending.

Profit before tax increased by £12.2m to £23.3m after inclusion of levies payable to the FSCS (£10.5m) resulting from defaults of other deposit-takers during the 'credit crunch', increased profit based payments to members of £4.7m (2007: £1.3m) and investment costs of £47.1m (2007: £38.0m).

The Bank has maintained a strong balance sheet position with consistent robust liquidity and capital ratios. As at the year-end, the capital ratio on a Basel II basis after regulatory deductions was 11.2% with a tier 1 ratio of 8.3% and a core tier 1 ratio of 7.6% reflecting the quality of our capital resources.

CFS holds capital ring-fenced for the Bank for various purposes, including capital to cover market stress. Early in 2009, CFS decided to move £120m of this capital into the Bank which was being held for the benefit of the Bank. This has reinforced the capital strength of the Bank and now means that the Bank is eligible for the Credit Guarantee Scheme implemented by the Government, although given the strong retail funding position any guaranteed issuance is currently unlikely. The Bank's capital ratio, after adjusting for the capital injection, is 12.5% with a tier 1 ratio of 9.6% and a core tier 1 ratio of 8.9%.

2008 has seen the dislocation in financial markets evolve into a wider economic slowdown. Funding markets remain volatile, with securitisation and covered bond markets effectively closed, and increased competition for customer deposits. The Bank has continued to take a prudent and disciplined approach to liquidity and funding and has maintained its detailed management of its liquidity position. The Bank has a very strong retail deposit base with customer deposits higher than customer lending such that its reliance on wholesale funding is lower than most other banks. Funding of lending by customer deposits has been maintained at a minimum of 100% through selective asset growth and development of customer deposit balances. As a result of this strength, the Bank has not been required to enter the markets at disadvantageous terms.

In addition, the Bank of England launched its Special Liquidity Scheme (SLS) which allows banks to swap their high quality mortgage-backed and other securities for UK Treasury Bills for a defined period. The Bank has developed a Covered Bond programme to enable it to access this and other facilities which may be extended by the authorities in the future to manage liquidity stress scenarios.

Results summary

	2008 £m	2007 £m	Change £m	Change %
Net interest income	**374.3**	334.8	39.5	11.8%
Non-interest income	**195.1**	188.7	6.4	3.4%
Operating income	**569.4**	**523.5**	**45.9**	**8.8%**
Operating costs	**(336.3)**	(339.3)	3.0	0.9%
Impairment losses	**(96.8)**	(102.0)	5.2	5.1%
Wholesale investment write downs	**(50.7)**	(31.8)	(18.9)	(59.4%)
Operating profit before tax and significant items	**85.6**	**50.4**	**35.2**	**69.8%**
FSCS levy*	**(10.5)**	–	(10.5)	–
Operating profit	**75.1**	**50.4**	**24.7**	**49.0%**
Profit based payments to members of the Co-operative Group	**(4.7)**	(1.3)	(3.4)	(261.5%)
Profit before tax and significant items	**70.4**	**49.1**	**21.3**	**43.4%**
Significant items	**(47.1)**	(38.0)	(9.1)	(23.9%)
Profit before tax	**23.3**	**11.1**	**12.2**	**109.9%**
Earnings per share	**1.23p**	**0.29p**	**0.94p**	**324.1%**
Operating profit before tax and significant items analysed by segment:				
Retail	**41.0**	38.0	3.0	7.9%
Corporate	**79.6**	55.8	23.8	42.7%
Wholesale	**(35.0)**	(43.4)	8.4	19.4%
	85.6	**50.4**	**35.2**	**69.8%**
Cost/income ratio before significant items	**59.1%**	64.8%	–	5.7%

*Financial Services Compensation Scheme levy

Retail banking

	2008 £m	2007 £m	Change £m	Change %
Net interest income	**234.1**	247.9	(13.8)	(5.6%)
Non-interest income	**157.2**	151.1	6.1	4.0%
Operating costs	**(265.5)**	(273.1)	7.6	2.8%
Impairment losses	**(84.8)**	(87.9)	3.1	3.5%
Operating profit before tax and significant items	**41.0**	**38.0**	**3.0**	**7.9%**
Cost/income ratio before significant items	**67.9%**	68.4%	–	0.5%

Retail operating contribution reflects higher non-interest income, reduced bad debts and lower costs, offset by lower net interest income. Growth in attractively priced savings and deposit products and continued progress in increasing secured lending balances has maintained our strong balance sheet and liquidity positions with a consequential reduction in retail interest margins. Retail non-interest income for 2008 includes £9.3m of gains on the visa share IPO (2007: nil).

Corporate banking

	2008 £m	2007 £m	Change £m	Change %
Net interest income	**116.8**	95.1	21.7	22.8%
Non-interest income	**35.2**	32.7	2.5	7.6%
Operating costs	**(60.4)**	(57.9)	(2.5)	(4.3%)
Impairment losses	**(12.0)**	(14.1)	2.1	14.9%
Operating profit before tax and significant items	**79.6**	**55.8**	**23.8**	**42.7%**
Cost/income ratio before significant items	**39.7%**	45.3%	–	5.6%

Increased corporate sector operating contribution reflects strong growth in operating income driven by higher lending and deposit balances. Growth in corporate lending has been controlled to maintain margins, high credit quality and liquidity. Additional costs have been incurred as part of the significant expansion in the number of Corporate Banking Centres during 2007 and 2008.

Wholesale banking

	2008 £m	2007 £m	Change £m	Change %
Net interest income	**23.4**	(8.2)	31.6	385.4%
Non-interest income	**2.7**	4.9	(2.2)	(44.9%)
Operating costs	**(10.4)**	(8.3)	(2.1)	(25.3%)
Wholesale investment write downs	**(50.7)**	(31.8)	(18.9)	(59.4%)
Operating profit before tax and significant items	**(35.0)**	**(43.4)**	**8.4**	**19.4%**

Improved wholesale sector performance reflects the Bank's balance sheet strength which enabled it to take advantage of conditions in the money market, including rapidly declining interest rates in the second half of the year. This has resulted in significantly improved wholesale margins.

However, the wholesale Bank incurred £50.7m investment write downs, mainly reflecting further deterioration in a small portfolio of structured investments (£28.2m) and Credit Trading Fund investments (£12.5m). The Bank's remaining exposure to higher risk structured and Credit Trading Fund investments has now been reduced to less than £17m. The investments against which provision has been made in 2008 has been restricted to only a small part of the Bank's portfolio in line with our prudent approach to investment, the rest of the portfolio remains of prime quality.

Investment in the future

Co-operative Financial Services (CFS) started the journey in 2006 to better serve its 6 million customers through transforming its business and technology capabilities.

This has resulted in a Group Programme of restructuring and significant non-recuring expenditure. Total costs of this programme in 2008 were £124.3m across CFS, of which the Bank incurred £47.1m as a significant item (2007: £38.0m).

CFS has commenced a substantial investment in new technology in 2008, via an Enterprise Platform Programme, to replace our retail and corporate banking system. This investment will allow CFS to re-engineer its customer facing and internal processes, and will provide an opportunity for further integration of our Banking infrastructure with that of the Insurance businesses so that we can be truly customer centric in the way we sell to and serve our customer base. This investment supports our customer relationship strategy across Banking, Insurance and Investments to deliver attractive, fair, accessible products on a scalable multi-channel basis.

Challenging the cost base

The investments so far have delivered a number of notable successes. Since early 2007, CFS has delivered significant underlying cost reductions. This has been realised through a range of activities including headcount reduction, improved procurement contracts, simplified business processes, enhanced capabilities, and an element of premises rationalisation.

People in our customer-facing roles were unaffected by these headcount reductions and CFS has re-affirmed its commitment not to off-shore any of its customer-facing sales and service operations.

External market turbulence

2008 has been a year of the most extreme market conditions with all asset categories experiencing periods of extreme volatility.

At the start of the year, fears grew about the impact of the sub-prime crisis on the global economy. Yields on government bonds fell and the price of riskier assets, such as equities and corporate bonds, declined. Financial concerns culminated in the rescue of Bear Stearns by JP Morgan in March and the US Treasury offering support to the financial system. This led to a degree of confidence returning to the markets, bond yields rising and the prices of riskier assets recovering. The focus of the markets then turned towards the strong rate of economic growth, particularly in developing countries which, with the rapid rise in commodity prices, raised concern over the rising rate of inflation. Oil prices rose to around $150 per barrel and UK inflation increased to 3.8% in June.

Subsequently, in the second half of the year, the credit market weakened sharply with the high profile failure of Lehman Brothers and the government bailouts of AIG, Fannie Mae and Freddie Mac in the USA and Bradford & Bingley in the UK. All the major governments took action to mitigate the impact on the real economy, including the UK bank recapitalisation programme in October and the Monetary Policy Committee cutting base rates aggressively from 5% to a current all time historic low of 0.5%. Corporate bond spreads increased to their widest ever levels with BBB rated bonds yielding around 630bps more than gilts. Inflation, which peaked at 5.2% in September, fell to 3.1% by the end of the year and is expected to fall further in 2009. Economic growth, after adjusting for inflation, turned negative at the end of the year and the UK entered recession.

Looking ahead, current forecasts suggest that the UK economy will remain in recession for most of this year and that 2010 will show only a modest recovery. Base rates are expected to remain low although the impacts on the Bank are being carefully managed and mitigated. Financial conditions are expected to remain difficult for much of the year with rising unemployment and more difficult conditions for both personal and business customers.

The impact on the Bank so far has been restricted through our balance sheet and liquidity strength, which have provided opportunities through our low reliance on wholesale funding. Our cautious approach to lending has also limited our exposure to increased credit losses, with our bad debt levels improving compared to 2007. 2009 is however expected to be a challenging year with increased pressure on bad debts and investments.

Balance sheet

Customer deposits and customer lending from the Bank's principal retail and corporate businesses areas have risen by 20% and 16% respectively during 2008.

Customer deposits of £10,633m grew by £1,745m (20%) across our main retail and corporate customer base. Customer lending balances in the same businesses grew by £1,376m (16%) to £9,905m reflecting growth in corporate and mortgage balances.

The Bank has maintained a strong balance sheet with consistently robust liquidity and capital ratios. The capital ratio on a Basel II basis after regulatory deductions was 11.2% with a tier 1 ratio of 8.3% and a core tier 1 ratio of 7.6% reflecting the quality of our capital resources. The ratio of customer deposits to customer loans remains strong at 107% (2007: 104%).

CFS holds capital ring-fenced for the Bank for various purposes, including capital to cover market stress. Early in 2009, CFS decided to move £120m of this capital into the Bank which was being held for the benefit of the Bank. This has reinforced the capital strength of the Bank and now means that the Bank is eligible for the Credit Guarantee Scheme implemented by the Government, although given the strong retail funding position any guaranteed issuance is currently unlikely. The Bank's capital ratio, after adjusting for the capital injection, is 12.5% with a tier 1 ratio of 9.6% and a core tier 1 ratio of 8.9%.

Retail sector customer lending balances increased by £595m (12%) compared to the end of 2007 driven by mortgage growth. Excluding mortgages, retail sector customer lending balances fell by £185m (10%) as the Bank continued its strategy to reduce its exposure to new-to-Bank unsecured loan and credit card customers. There remains a focus on developing lasting relationships with customers, through products such as current accounts and mortgages, who are more likely to acquire other products across the CFS range including insurance. The Bank's customer and marketing strategies are driven by a focus on customers who share our belief in the Co-operative difference, developing strong loyal relationships based on the total CFS product range, recruiting and retaining relationship customers and a customer promise that sets our commitment.

Growth in mortgages of £780m (24%) has been delivered through award-winning and market leading products, which have resulted in a consistent presence in best buy tables with mortgage applications at record levels. The Bank was the winner of 'Best Remortgage' and 'Best First-Time Buyer' by Moneywise at the 2008 Mortgage Awards. It was also highly commended for 'Best Flexible Mortgage'. This growth has been achieved without compromising the quality of the portfolio as average loan-to-value over the last 12 months has remained constant at 53%. Additionally, in light of increased uncertainty in the property market, the maximum loan-to-value for new business was reduced from 90% to 85% for Repayment mortgages and to 75% for Interest Only and new build properties in October 2008. We substantially withdrew from new Buy-to-Let mortgages in early 2006, with complete withdrawal from early 2008. Our remaining exposure to Buy-to-Let mortgages is only around 1.0% of our customer loans.

Lending

	2008 £m	2007 £m	Change £m	Change %
Retail	**5,700.2**	5,105.6	594.6	12%
Corporate (excl. subsidiaries)	**4,204.5**	3,422.9	781.6	23%
	9,904.7	**8,528.5**	**1,376.2**	**16%**
Wholesale	**244.7**	360.0	(115.3)	(32%)
Lending through subsidiaries	**156.9**	120.5	36.4	30%
	10,306.3	**9,009.0**	**1,297.3**	**14%**

The Bank launched an Ownhome shared equity scheme in collaboration with Places for People to allow a widening of home ownership and increase housing affordability for eligible key workers, first-time buyers and social housing tenants.

Corporate lending balances within the Bank increased by £782m (23%). The promising growth in corporate lending balances includes participation in PFI transactions. The Renewable Energy and Asset Finance team have been involved in funding a variety of renewable energy investments from hydro schemes, to wind farms and combined heat and power plants. These schemes help establish the Bank as a serious player within this market and demonstrate our commitment to the environment, generating significant carbon savings as well as income. In the Corporate market, credit conditions have tightened as the effects of the 'Credit Crunch' begin to take hold. Lack of liquidity amongst lenders, coupled with falling property values and rising insolvencies has made credit harder to secure. The price of credit therefore has risen as has the risk profile of our customer portfolio. This is being reflected in the performance of a greater number of businesses as they encounter a general downturn in activity and its consequent effect on cashflow and earnings. This means we are increasing our resources focused on key control activities whilst continuing to adopt a cautious and prudent approach to corporate lending. However, we will remain alive to the opportunities generated by changing market conditions to build on our well established reputation for high quality customer service and gain new business from other market participants.

Deposits

	2008 £m	2007 £m	Change £m	Change %
Retail	**7,936.0**	6,757.7	1,178.3	17%
Corporate (excl. subsidiaries)	**2,696.6**	2,129.6	567.0	27%
	10,632.6	**8,887.3**	**1,745.3**	**20%**
Wholesale	**766.4**	1,177.0	(410.6)	(35%)
Deposits through subsidiaries	**509.8**	495.2	14.6	3%
	11,908.8	**10,559.5**	**1,349.3**	**13%**

Average balance and interest margins

	2008 £m	2007 £m	Change £m
Net interest income	**374.3**	334.8	39.5
Average balances:			
Interest-earning assets	**13,419**	12,193	1,226
Interest-bearing liabilities	**11,415**	10,319	1,096
Interest-free liabilities	**2,004**	1,874	130
Average rates:	**%**	%	%
Gross yield on interest-earning assets	**6.1**	6.5	(0.4)
Cost of interest-earning liabilities	**4.0**	4.5	(0.5)
Interest spread	**2.1**	2.0	0.1
Contribution of interest-free liabilities	**0.7**	0.7	–
Net interest margin	**2.8**	2.7	0.1

Retail sector balances of £7,936m were £1,178m (17%) higher than last year. This growth has been achieved through the attractiveness of the smartsaver, Privilege Packaged Account and term deposit products, maintaining the Bank's strong balance sheet position. The Bank has also delivered a new customer proposition with the new Current Account Plus, combining a current account with a linked savings product. The product provides customers with a fee-free overdraft and a savings account paying a competitive rate of interest. It is a multi-channel product being available across the Branch network, Telephone and Internet services. The Bank also launched newly-improved packaged current accounts which enable customers to enjoy a unique, extensive and generous package of benefits. The Bank was the first UK bank to give customers the opportunity to tailor their benefits to suit their needs and can choose one of 3 'bundles' to bolt-on at no extra charge. These have contributed to retail bank current accounts held increasing by more than 75,000 (8%).

Corporate sector deposits from the Bank's principal business increased by £567m (27%). Growth on term deposits has been targeted to increase still further the stability of the Bank's funding base. We have opened 6 new Corporate Banking Centres across the United Kingdom and in only 2 years have doubled the number of centres to 20.

Market leading customer satisfaction is one of our key business measures and despite a challenging economic climate, our customer satisfaction levels continue to receive external recognition as we aim to grow our business through delivering value, fairness and social responsibility. In December 2008, 76.5% (2007: 79.4%) of our customers claimed to be either 'Extremely' or 'Very Satisfied' with the products and service that we provide.

The Bank and **smile** received further recognition from the Watchdog customer survey and the Which? Survey. Watchdog awarded **smile** 2nd and Co-operative Bank 3rd for customer satisfaction ahead of all other high street banks, whilst **smile** was awarded 'Best Buy Current Account Provider' by Which?. The Bank was also ranked highest by JD Power and Associates in its report on Customer Satisfaction with Retail Banks in the United Kingdom. The People's Choice report from Which? also awarded **smile** the highest customer satisfaction score for current accounts.

Working with the wider Co-operative Group

The Bank's links with the wider Co-operative Group have continued as the Bank manages and operates ATMs located in retail stores. The total number in the Bank's network is approximately 2,200.

The Bank has launched four new banking outlets in the convenience stores of its sister Food business. These new concepts offer automated self-service banking for customers, such as cash withdrawals and cash and cheque deposits. In addition, there are touch screen kiosks providing product information and capturing customer details for subsequent sales and service discussions, with sales assistants in the larger stores able to offer more information and support. This concept, launched in Nottingham and Sussex, moves away from the traditional high street branch to a lower cost current account banking model, with more convenience for the customer in location and hours. We will assess the pilot with a view to rolling out based on experience of what is successful.

2008 has also marked the launch of a new brand for our Bank, Insurance and Investments brands which is an exciting step that brings our different businesses closer together, making it easier for our customers to recognise the comprehensive range of benefits and services available to them and strengthening our approach to being good with money. The Brand programme has delivered a number of successes, including the launch of a new TV advert, attendance of 4,000 CFS colleagues at good with money Events which reinforce our Brand values, and the launch of a single website for Bank, Investments and Insurance offerings. The majority of branches have been re-branded, whilst ATM rebranding is in progress.

The re-branding of our business is part of a wider plan involving all the family of businesses within the Co-operative Group – Food, Farms, Funeral, Banking, Insurance, Investments, Travel, Pharmacy and Legal Services. The Co-operative's brand campaign helps customers to understand the breadth of the family of businesses and what makes the co-operative model of business different.

The new campaign includes television, cinema, press and branch advertisements. The new TV advert was launched on 16 February and lasted the entire 2.5 minutes advertisement break during Coronation Street – the first time the entire break has ever been used in this manner in the show's history and the TV ad is soundtracked by Bob Dylan's classic: *Blowin' In The Wind.*

We also announced in January 2009 our plans to create the UK's most diversified mutual in UK financial services through a merger with Britannia Building Society. This would combine our strong personal and corporate banking, insurance and investment expertise with Britannia's extensive high street presence and savings and mortgage strength. Britannia members will need to approve the deal in a vote at a general meeting expected to take place on 29 April 2009. Provided members vote in favour, the merger is expected to complete by the end of July. On completion Britannia's assets and liabilities will become part of The Co-operative Bank and the Britannia members will become members of the Co-operative Group.

Non-interest income

	2008 £m	2007 £m	Change £m
Fees and commission receivable	**193.0**	187.3	5.7
Insurance commission income	**23.5**	29.2	(5.7)
Fees and commission payable	**(35.6)**	(33.3)	(2.3)
Visa share IPO gain	**9.3**	–	9.3
Dealing profit/losses	**4.9**	5.5	(0.6)
Total	**195.1**	**188.7**	**6.4**

Operating costs

Operating cost analysis before significant items.	2008 £m	2007 £m	Change £m
Wages and salaries	**108.2**	111.1	2.9
Pensions and social security costs	**20.9**	21.4	0.5
Other staff costs	**22.0**	12.8	(9.2)
Staff costs	**151.1**	145.3	(5.8)
Other administration expenses	**165.1**	171.3	6.2
Deprecation and amortisation	**20.1**	22.7	2.6
Total operating costs	**336.3**	**339.3**	**3.0**
Cost/income ratio before significant items	**59.1%**	64.8%	5.7%
Average staff numbers	**3,990**	4,281	(291)

Credit quality and impairment losses

Impairment losses	2008 £m	2007 £m	Change £m
Retail sector	**84.8**	87.9	3.1
Corporate sector	**12.0**	14.1	2.1
Total	**96.8**	**102.0**	**5.2**
Charge as a percentage of loans and advances to customers	**0.9%**	1.1%	0.2%

Operating income at £569.4m was £45.9m higher than the same period last year reflecting a £39.5m increase in net interest income and an increase of £6.4m in non-interest income.

Higher interest income from balance sheet growth across product and business segments and improved wholesale margins, arising from investment of the Bank's deposit base, has been offset by lower retail margins. The Bank has reduced its exposure to unsecured lending and offered market leading deposit and term products to further strengthen the balance sheet. This was alongside strong growth achieved in secured mortgage and corporate lending. Mortgages and Corporate syndicated and property lending represent a lower credit risk compared to unsecured retail lending and so attract a lower margin. This reflects our continuing marketing strategy which is now focused towards customers who share the Co-operative values, seeking to build profitable relationships across the CFS banking and insurance products.

Non-interest income at £195.1m was £6.4m higher than the same period last year, largely due to growth in corporate commission and profit on shares in Visa international from their Initial Private Offering offset by lower insurance commission from Payment Protection Insurance.

The Bank has maintained tight cost control in the period which has resulted in business-as-usual operating costs reducing by £3.0m (0.9%). This has been achieved through the cost reduction programme as referred to on page 13.

Wages and salaries, and related pension and social security costs, reduced by £3.4m (2.6%) reflecting reduced staff numbers.

Increases in other staff costs reflect temporary resources on payments related projects such as the Faster Payments service. The new and innovative Faster Payments service between UK Banks has been launched and the Bank as a founder member has started its participation in the scheme.

Additionally, the Bank has recognised £10.5m for two years of charges relating to the Financial Service Compensation Scheme arising from defaults of other deposit-takers during the 'credit crunch'. These charges are not included in the above analysis but are disclosed separately and are included within operating profit for statutory purposes.

The impairment charge of £96.8m was £5.2m lower than last year. This was achieved, in spite of a weaker economic environment, and reflects action in previous years to improve credit quality, particularly in the unsecured retail portfolio. The secured mortgage book continues to incur low levels of default averaging less than one quarter of the average rate experienced by other Council of Mortgage Lenders member institutions. The subsequent impairment reflects the relatively low average loan-to-value ratio and these factors are also reflected in the very low level of properties taken into possession being only 19 in 2008. Retail sector impairment losses were £3.1m lower than last year representing 1.5% (2007: 1.7%) expressed as percentage of average retail lending.

In May, the Bank also launched the Verified by Visa service to customers as part of the industry wide focus on reducing losses through fraudulent online shopping. As a further initiative to protect our customers against card fraud, the Bank has also developed a new self service facility for customers to confirm that transactions are genuine called Automated Voice Messaging which enhances ability to prevent card fraud at the earliest possible stage.

Corporate sector impairment losses were £2.1m lower than last year and remain relatively low at 0.3% of average customer balances. The credit quality of the corporate portfolio has been maintained although even well-led businesses operating robust business models are beginning to experience earnings challenges. This is reflected in performance covenants being breached with evidence that this is now spreading beyond the property and retail sectors. Our customers had avoided the worst effects of the downturn until quite recently which demonstrates their previous robustness and credit quality but it is clear the widespread nature of the current conditions will now mean its impacts are experienced by almost all businesses. The inevitable consequence of higher impairment losses however will be mitigated in part by the underlying quality of the portfolio, but 2009 will be a challenging year across the whole sector.

Summary and outlook

2008 was a solid year for CFS, including the Bank, and we made good progress towards our vision to become the 'UK's most admired financial service business'.

During a time of economic slow down, which has seen many of our competitors experience difficulties, we have continued to deliver a strong financial performance and award-winning levels of customer satisfaction.

Our strategy is serving us well and our business performance highlights the underlying strength and sustainability of our business, which is seeing increasing numbers of customers recognising our brand commitment to value, fairness and social responsibility.

The contrast in performance between CFS and many of our competitors has been stark this year and re-enforces the strength of the Co-operative model.

2009 will bring further challenges and the economic outlook is uncertain. We will continue to deliver change initiatives, which will deliver immediate benefits, meet regulatory requirements and further improve the control environment. Managing our cost base will continue to be a priority.

CFS has commenced a substantial investment in new technology in 2008, via an Enterprise Platform Programme, to replace our retail and corporate banking system. This investment will allow CFS to re-engineer its customer facing and internal processes, and will provide an opportunity for further integration of our Banking infrastructure with that of the Insurance businesses so that we can be truly customer centric in the way we sell to and serve our customer base. This investment supports our customer relationship strategy across Banking, Insurance and Investments to deliver attractive, fair, accessible products on a scaleable multi-channel basis.

Whilst we are not immune from the economic slowdown, we have a robust business model, strong brand and a clear path for the future of our business, including our proposed merger with Britannia Building Society. If approved, this will provide our customers with access to an expanded network of more than 300 branches and will create a strongly capitalised business with £70 billion of assets and nine million customers.

We chart our progress towards our vision: to be the UK's most admired financial services business, through our five **key performance indicators** which together measure our

1. Profit generation to create a sustainable model

The key financial performance measure is profitability. Additional supplementary measures are cost/income ratio and net interest margin.

Profitability is defined as operating profit before significant items and is the key financial performance measure in the CFS Group.

The Bank's operating profit before tax, Financial Service Compensation Scheme levy and significant items increased by £35.2m (69.8%) to £85.6m as strong balance sheet growth was achieved in both lending and deposit balances resulting in higher non and net interest income. Bad debt and operating costs have also improved on 2007. The Bank's income was also substantially above target levels. However, the Bank's contribution to CFS' result was below target, primarily because of investment write downs.

Cost/income ratio is calculated as operating expenses before significant items divided by operating income before significant items. This was significantly better than 2007, due to strong income and balance sheet growth and tight cost control.

Net interest margin is net interest income divided by interest-earning assets. This improved slightly compared to 2007.

2. Market leading colleague satisfaction

At the Co-operative Financial Services, including the Bank, we are very aware that our success is driven by our people, and throughout 2008 we pursued a number of strategies to increase the engagement levels among colleagues. In common with many businesses across the world, we use a colleague opinion survey – in our case, the survey is called ECHO (Every Colleague Has Opinions) – to measure how many of our people are engaged with the business.

Engagement is based on three core elements:

- Emotional attachment to the organisation;
- Willingness to stay with the organisation; and
- Discretionary effort – how much colleagues are motivated to go beyond their normal duties to help the organisation achieve its aims.

These measures are often referred to as 'Say, Stay and Strive', and our ECHO survey shows us what proportion of our colleagues feel positive across all three elements.

This proportion is known as our Engagement Index (EI), and, in 2008, the EI score was 64%, an increase of 11 percentage points from the previous year. This represents remarkable progress against our strategic plan, which was to increase the EI score by 5 percentage points per year, and demonstrates the effectiveness of the corporate strategies in 2008. These included:

- The Leadership Challenge – an in-depth development programme for more than 1,100 people managers across the organisation to develop understanding of best practice around the behavioural aspects of leadership; and
- The good with money event – a one-day workshop for all colleagues to develop their understanding of our brand proposition and their role in delivering this.

  Our strategic target will continue to be based on the average EI for the Hay Group Insight High Performance Norm Group – a group of top-performing global organisations across all sectors that work with Hay Group Insight, our partner organisation in the administration and interpretation of the ECHO Survey. In 2008, the High Performance Norm Group EI was 77%.

  In 2009, we will work to further improve our engagement score, and also look at how, as an organisation, we make the most of this high level of engagement by making sure our processes and support allows these engaged colleagues to be as effective as they can be in providing products and services to our customers and members.

3. Market leading customer satisfaction

Our current measurement of overall customer satisfaction is derived from GFK NOP's syndicated Financial Research Survey (FRS). The FRS is the largest survey in the marketplace (with 60,000 Financial Services customers interviewed each year).

Customers register their satisfaction levels with their providers at product level on a seven point scale – Extremely, Very, Fairly, Neither/Nor, Fairly Dissatisfied, Very Dissatisfied, Extremely Dissatisfied. Product level scores (based on Extremely & Very Satisfied responses) are then weighted by customer numbers to produce Business Unit level scores and an overall

measure for CFS. To ensure a statistically robust sample per CFS product area and to even out any seasonal variations in scores, a rolling 12 month's worth of data is used.

A target measure of 64.6% was set at the start of 2008 against which CFS has performed well, achieving the targeted score (64.6%) at the end of December. Although there has been a trend of decline for our Retail Bank business, we have maintained the gap ahead of the market (Top Five by Market Share) with a score for Extremely/Very Satisfied of 76.5%, compared to 63.3% for the market.

4. Market leading social responsibility approach

In 2008, CFS, including the Bank, measured its progress towards its goal of a market leading social responsibility approach using the following three indicators. Two of the three targets set for attainment in 2008 have been achieved, and one has been partially achieved.

The first indicator looks at unprompted public awareness of the Bank and Co-operative Insurance/Investments as financial services businesses that take social responsibility into account. This measure derives from an independent survey of 1,000 members of the general public, which, in 2008, was undertaken in March. Targets set for 2008 sought a number one ranking for the Bank and number two ranking for Co-operative Insurance/Investments. Against these, the Bank retained the number one ranking, with a score of 8% (2007: 11%), and Co-operative Insurance/Investments ranked joint third, recording unprompted awareness of 2% (2007: 3%).

The second and third indicators look at performance in Business in the Community's Corporate Responsibility Index and Environment Index. The Indexes are voluntary self-assessment surveys that benchmark Corporate Responsibility and Environmental strategy (and their integration), management, reporting and performance across a range of issues. The 2008 targets were to seek a Platinum (leading group) ranking for CFS by achieving a score of 95% or more in both Indexes. In the Corporate Responsibility Index 2007, which was published in May 2008, CFS achieved a Platinum ranking, attaining a score of 98% and emerging as a sector leader. In the Environment Index, CFS achieved a Platinum ranking, attaining a score of 99%. In relation to the 2008 index, CFS will be seeking to maintain its Platinum ranking.

5. Growing and engaging membership

Increase in active members

The Co-operative Group is jointly owned and democratically controlled by its members. Members of our co-operative enjoy a share in our profits and can exercise their democratic control, with equal rights and benefits. Growing a strong and committed membership base is integral to our vision and beliefs and is an integral part of our brand. Growing engagement with our customers via membership is a key element in delivering a competitive advantage and achieving our social goals.

Whilst we are committed to growing our membership base, we recognise the importance of ensuring that our members are engaged with the Co-operative. True engagement will be reflected in both transactional and democratic participation. The focus of 2009 is therefore to drive active engagement from our members. This will be demonstrated by increasing participation rates across the diverse range of businesses offered by the Co-operative Group, so that individual members transact with multiple businesses. Inevitably, this type of activity will also attract new members. In 2008, the number of Co-operative members trading with The Co-operative Financial Services increased by over 140,000, which was a massive increase of 33% on 2007's performance.

Growth in total points earned

A key element of the brand and membership programmes has been the introduction of a true dividend where members receive a share of our profits by way of a cash dividend, the scale of which is directly determined by the value of trade that they have carried out across our various businesses.

As part of our aim to grow and engage membership, therefore, we track the total value of points earned by members through their trade across our businesses. Members earn points for every £1 they spend with all of our businesses, from holidays and food to insurance and banking. The total points earned by members are captured within our dividend system and determine, for each individual member, the size of their share of our profits. In 2008 members earned 1,912 million points, an increase of 35% on the prior year.

Our **corporate responsibility policy** is driven by our customers' support for sustainable development and financial investments that are

Corporate responsibility

Sustainable development

At The Co-operative Bank we have a proud history of corporate responsibility, central to which is managing and developing the business in a sustainable manner, as spelled out in The Co-operative Financial Services' Sustainable Development Policy.

We are guided by the views and expectations of members, customers and other stakeholders, and have committed to delivering value to partners in a socially responsible and ecologically sustainable manner. Our employees have identified social responsibility as one of the five values which provide direction to The Co-operative Financial Services and contribute to business success. The Co-operative movement's values of self-help, self-responsibility, democracy, equality, equity and solidarity are also key to our way of doing business.

Over the last year, businesses have been faced with an increasingly uncertain economic climate. It is against this background that The Co-operative Bank launched its fifth, and to date most successful, Ethical Policy consultation. A record 80,000 customers came forward to endorse the Policy, providing a new and expanded mandate on a range of crucial issues.

It is this kind of leadership that helps The Co-operative Financial Services to maintain market-leading levels of trust amongst its various stakeholders. In 2008, The Co-operative Bank out-performed its nearest rival in the 'Concerned Consumers Index' of banks and building societies, by a considerable margin. The index is based on independent research into consumers' impressions of business behaviour. And in July 2008, The Co-operative Financial Services won the prestigious Business in the Community (BitC) Impact on Society Award, which carries the title of BitC 'Company of the Year'. The award was in recognition of our embedded approach to sustainable development.

Management

The Co-operative Group's Social Goals and Sustainability department is responsible for the day-to-day management of our sustainability agenda.

Our sustainability performance is measured against a wide range of economic, social and environmental indicators, and is reported in The Co-operative Group's Sustainability Report. This annual report is considered by the values and principles committee (a sub-committee of the Board), which oversees sustainability strategy, performance and management.

Once again, in 2008, The Co-operative Financial Services ranked in the Platinum Group of leading companies in three separate BitC indices: Corporate Responsibility, Environment, and Community, with scores of 98% and above.

Social responsibility

Ethical finance

Over the years, The Co-operative Bank has been a pioneer in the area of ethical finance, and is still the only bank to have a customer-led Ethical Policy. Launched in 1992, the Policy seeks to ensure that customers' money is invested in line with their values.

In 2008, The Co-operative Bank launched its fifth Ethical Policy consultation. For the first time, customers were invited to participate in the consultation via a national television advertising campaign, as well as via statement inserts. More customers than ever took the opportunity to have their say and overwhelmingly provided The Co-operative Bank with a mandate on a range of new issues, including: human rights, climate change, international development and animal welfare.

The Co-operative Bank's policy ensures that potential corporate and business banking customers are screened to ensure that their business practices pose no conflicts with the Ethical Policy. If they do, finance is declined. In 2008, of the 356 finance opportunities assessed by our Ethical Policy unit, 36 were found to be in conflict and were turned away. Since the launch of the Policy in 1992, The Co-operative Bank has declined an estimated £1 billion. Over the same period, The Co-operative Bank's commercial lending has gone from strength to strength, and in December 2008, stood at £4.4 billion. Crucially, around a third of The Co-operative Bank's assets are with organisations that have a distinct co-operative, ethical or social purpose.

The Co-operative Bank continues to be the largest provider of banking services to the credit union sector, providing facilities to over 60% of the British movement. Following The Co-operative Bank's work with the Association of British Credit Unions, 11 credit unions are now able to offer banking services (including a debit card, ATM withdrawals, direct debits and standing orders) to their members; The Co-operative Bank providing behind the scenes service and administration. Development of the credit union current account was seen as a step change in credit unions' ability to address financial inclusion, and an average of 150 of these accounts were being opened every week during 2008 and the account will be rolled out to a further seven credit unions in 2009. The Co-operative Bank also supports a range of charities through affinity cards; each partner receives a donation from The Co-operative Bank for each new card that's issued and a donation each time the card is used. Its Woodland Trust credit card won Best Charity Credit Card programme in the 2009 Credit Card Awards.

Concern for the community

As one of the seven co-operative principles, 'concern for the community' is at the core of The Co-operative Financial Services' approach. Following extensive member consultation, a new community plan was launched in February 2009, which will develop future community involvement into the three main areas of; poverty in the developing world, climate change and young people.

We measure our support for the community using the London Benchmarking Group (LBG) model, which quantifies both cash and in-kind donations. In 2008, The Co-operative Financial Services contributed a total of £3.4m to charitable causes (2007: £3.4m), the equivalent of 2.3% of The Co-operative Financial Services' pre-tax profit.

Our commitment to the community has always extended beyond financial support. Employees are encouraged to take advantage of various volunteering opportunities, whether it is a team challenge, such as creating a community garden, or an individual one, such as mentoring a young person. In 2008, 670 Co-operative Financial Services employees registered that they had taken part in volunteering activities in work time, altogether contributing a total of 963 hours.

Throughout 2008, to mark the 60th anniversary of the Universal Declaration of Human Rights (UDHR) we joined forces with Amnesty International to campaign on Defending Human Rights. The campaign included support for a short film that was shown in cinemas throughout the UK, and an education pack, which reached over 90% of UK schools. We also asked customers to sign a pledge to 'Make the World Keep its Word' on human rights and add their name to the UDHR. In addition, monies totalling £150,000 were donated to five leading human rights groups.

The Co-operative Bank's pioneering work with prisoners continued throughout 2008. The initiative provides soon-to-be-released prisoners with basic bank accounts; an often vital requirement of holding down a job or securing accommodation, and a provision that can reduce re-offending rates. Following the pilot phase of the project, based at Forest Bank Prison in 2006, The Co-operative Bank has now accepted account applications from 28 other prisons.

Environment

The responsible management of energy, waste, transport, man-made chemicals and biodiversity impacts are key to The Co-operative Bank's vision of a more sustainable future. Climate change is clearly a driving imperative, and our work to tackle this has focused on renewable energy consumption and generation, energy saving, carbon offsetting and the provision of finance.

We led the switch to green energy back in 1998, and currently source virtually all of our electricity from good quality renewable sources, such as wind and water.

We're also involved with directly creating renewable energy, having developed the UK's largest solar project at The Co-operative Insurance's head office. As a result, our greenhouse gas emissions have dropped by over 59% against a 2002 baseline, a 3% improvement on the previous twelve months.

While other companies are beginning to tackle their contribution to climate change, The Co-operative Financial Services' operations have already gone 'beyond carbon neutral' – offsetting 110% of our remaining carbon dioxide emissions that come from our transport and gas consumption. We use Climate Care to offset our remaining greenhouse gas emissions, through renewable energy, energy efficiency and rainforest reforestation projects in the developing world. We also offset an additional 10%, in order to account for legacy issues. The Co-operative Bank has been pioneering carbon offset schemes since 2000, and has already donated over £1million to combat climate change on behalf of our mortgage customers.

The Co-operative Financial Services also continues to be the only major financial services provider in the world to secure total business certification to the ISO 14001 environmental management standard across all of our activities, products and services.

In May 2008, The Co-operative Financial Services was recognised as the highest ranking UK financial services provider in the Sunday Times Best Green Companies list. This ranking took into account the views of employees, as well as assessing the company's environmental performance, policies and business practices.

The **executive committee** is responsible for the day-to-day running of the

David Anderson

Mike Fairbairn

Barry Tootell

John Reizenstein Dick Parkhouse Rod Bulmer Helen Taylor

Our **wellbeing** function aims to make work a better place to be.

In 2008, The Co-operative Financial Services created a new well-being function which touches the working lives of all colleagues. Based on the premise that 'making work a better place to be' benefits the business, colleagues and customers, and is closely aligned with our co-operative vision and values, the well-being team provides a diverse range of services.

The Co-operative Financial Services recognises that health, safety and welfare at work are a vital part of the well-being agenda. We view our legal responsibilities as a minimum standard to be achieved, and work closely with our colleagues in the wider Co-operative Group to provide joint solutions to health and safety issues.

We provide all Co-operative Financial Services colleagues with the opportunity to participate in well-being events, from health promotion days to encouraging green travel. Our head office has a well-supported on-site gym and access to a variety of therapists. We are developing a network of well-being champions to support the development of similar programmes for colleagues at bank branches and other locations.

All Co-operative Financial Services colleagues and their immediate families have 24/7 access to an external Employee Assistance Programme, providing free expert advice on everything from medical to legal and family issues. We are developing and enhancing our occupational health provision to support colleague health and promote initiatives which will mirror current Government activity on health in the workplace and beyond.

The Co-operative Financial Services recognises the business benefits of a comprehensive well-being programme and will maintain this good progress into 2009 and beyond.

We work to ensure everything we do has our 'customers and members' **best interests at heart.** We are the members of the

The Board Graham Stow Martyn Wates Dick Parkhouse Bob Burlton John Reizenstein

Graham Bennett Simon Butler Stephen Watts

Our **business continuity** plans protect our critical operations from the risk of disruptions.

As part of our wider operational risk management framework, effective business continuity planning ensures that the interests of customers, employees and other stakeholders are protected by minimising the risk of disruption to critical business operations caused by unplanned events. Business Continuity Management continues to ensure that the risks of such incidents are reduced through appropriate resilience measures and, should the worst happen, that we have procedures in place to minimise impacts and to direct our response.

The Co-operative Bank is covered by The Co-operative Financial Services Business Continuity Management Policy and in 2008 this policy was revised in line with best practice and organisational changes. The Business Continuity Management team's policy and framework were reviewed by Internal Audit who confirmed that the framework is well established. Incident Response team members located at our major occupancies participated in scenario exercises to test our preparedness in the event of a major operational disruption, and teams continued to show an improvement in their capability. The Co-operative Financial Services Crisis Management framework was tested from an operational perspective during 2008 in relation to liquidity and funding in response to the current financial environment and regulatory expectations.

In 2009, The Co-operative Financial Services Executive will review the overall business impact analysis findings – the method to confirm Co-operative Financial Services' key processes during a major incident and their related systems – and the overarching continuity priorities. Business units will align plans and arrangements to ensure our capacity requirements are met. Building on the scenario exercises in 2008, Incident Response teams and the Crisis Management team, including Executive interaction, will undertake further exercises and we will continue to assess our plans and arrangements against industry best practice.

David Davies Terry Morton David Anderson Len Wardle Paul Hewitt Barry Tootell Bob Newton

Piers Williamson Kathryn Smith

The Co-operative Bank Board

Non-Executive Directors:

Graham Bennett (CCMI). Age 58. Joined the Board in 1989 and was appointed Chair in 2000. Spent his management career with Southern Co-operatives where he was the Society's Chief Executive for 25 years, and is now the Head of Investment Property. Vice Chairman of Unity Trust Bank plc. Non-Executive Director of Co-operative Group Limited, Co-operative Financial Services Limited, Co-operative Insurance Society Limited, and CIS General Insurance Limited.

Bob Burlton (BSc (Hons), Cert Dip). Age 60. Joined the Board in 2004 having previously served between 1993 and 2001. Strategic Projects Executive at Midcounties Co-operative. Elected President of Consumer Co-operatives Worldwide in 2005. Non-Executive Director of Co-operative Group Limited, Co-operative Insurance Society Limited, and CIS General Insurance Limited and Chair of Co-operative Financial Services Limited.

Simon Butler (BEd (Hons)). Age 54. Joined the Board in 2003. Member of the Central & Eastern Regional Board of Co-operative Group Limited and has been involved with consumer co-operatives for over 20 years. Non-Executive Director of Co-operative Group Limited, and Co-operative Financial Services Limited, and Chair of Co-operative Insurance Society Limited, and CIS General Insurance Limited.

David Davies (BSc (Econ), FIA). Age 61. Joined the Board in 2003 and is the Senior Independent Director. Qualified as an actuary. Chair of Sun Life Assurance Company of Canada (UK) and Nortel Network Pension Scheme in the UK. Also holds directorships with Hermes Fund Managers and Policy Mutual Assurance Society. Non-Executive Director of Co-operative Financial Services Limited, Co-operative Insurance Society Limited, and CIS General Insurance Limited.

Paul Hewitt (MA, ACA, Dip German (Open)). Age 53. Joined the Board in 2003. Holds Non-executive Directorships with Kiln, GMT Aviation, and the Personal Accounts Delivery Authority, and is Chair of YSC, an HR consultancy. Professional Non-Executive Director of Co-operative Financial Services Limited, Co-operative Insurance Society Limited, and CIS General Insurance Limited.

Terry Morton (BSc (Hons), CEng, MIET, MCMI). Age 63. Joined the Board in 2006. Member of the North East & Cumbrian Regional Board of Co-operative Group Limited. Managing Secretary of Durham Alliance for Community Care, a member co-operative that provides day care for challenged older people. Non-Executive Director of Co-operative Group Limited, Co-operative Financial Services Limited, Co-operative Insurance Society Limited, and CIS General Insurance Limited.

Bob Newton (BSc, FIA, CDir). Age 59. Joined the Board in 2007. Retired from the insurance industry in 2006, since when he has built up a portfolio of business and pro bono interests. Holds Non-Executive Directorships with UIA (Insurance) Limited, and AI Claims Solutions plc. Independent Professional Non-Executive Director of Co-operative Financial Services Limited, Co-operative Insurance Society Limited, and CIS General Insurance Limited.

Kathryn Smith Age 49. Joined the Board in 2001. Member of the South East Regional Board of Co-operative Group Limited and South London Area Committee where she became Chair in 1990. Also Chair of Co-operative Action Limited and Co-operative Action Foundation. Director of Social Enterprise London, and Chair of Co-operatives London. Non-Executive Director of Co-operative Group Limited, Co-operative Financial Services Limited, Co-operative Insurance Society Limited, and CIS General Insurance Limited.

Graham Stow (CBE, FCIB, FCIPD, FRSA). Age 64. Joined the Board in 2003. Former Chief Executive of Britannia Building Society and Chair of Building Societies Association. Chair of IPRISM Underwriting Agency, Member of the Advisory Board of Kiddy & Partners, and Chair of the Governors of Staffordshire University. Non-Executive Director of Co-operative Financial Services Limited, Co-operative Insurance Society Limited, and CIS General Insurance Limited.

Len Wardle Age 64. Joined the Board in 2006. Member of the South East Regional Board of Co-operative Group Limited. Held management positions in local government and was latterly a Fellow at the University of Surrey in the School of Management. Director of Communicate Mutuality Limited. Chair of Co-operative Group Limited, Non-Executive Director of Co-operative Financial Services Limited, Co-operative Insurance Society Limited, and CIS General Insurance Limited.

Martyn Wates (ACA, ATII, BA (Hons)). Age 42. Joined the Board in 2007. Appointed Chief Financial Officer of Co-operative Group Limited following its merger with United Co-operatives and has held various finance positions within the co-operative movement. Non-Executive Director of Co-operative Financial Services Limited, Co-operative Insurance Society Limited, and CIS General Insurance Limited.

Stephen Watts (MA (Cantab)). Age 57. Joined the Board in 2006. Member of the Central & Eastern Regional Board of Co-operative Group Limited. Works for Cambridge Regional College as Pricing, Research, and Information Officer within the Directorate of Employment & Skills. Non-Executive Director of Co-operative Group Limited, Co-operative Financial Services Limited, Co-operative Insurance Society Limited, and CIS General Insurance Limited.

Piers Williamson (BA (Hons), ACIB, MCT). Age 47. Joined the Board in 2005. Holds Non-Executive Directorships with various Industrial and Provident Societies and funding vehicles associated with the Housing Finance Corporation where he is Chief Executive. Independent Professional Non-Executive Director of Co-operative Financial Services Limited, Co-operative Insurance Society Limited, and CIS General Insurance Limited.

Executive Directors:

David Anderson (MA (Oxon)). Age 53. Joined the Board in 2005. Chief Executive of The Co-operative Bank p.l.c. Prior to joining the group, was Chief Executive of Jobcentre Plus and Yorkshire Building Society. Also Chief Executive of Co-operative Financial Services Limited, Co-operative Insurance Society Limited, and CIS General Insurance Limited.

Dick Parkhouse (LLB, MBA, CIB). Age 54. Joined the Board in 2008. Managing Director, Retail Division. Also Executive Director of Co-operative Financial Services Limited, Co-operative Insurance Society Limited, and CIS General Insurance Limited.

John Reizenstein (MA (Cantab)). Age 52. Joined the Board in 2004. Managing Director, Corporate & Markets. A member of the Financial Reporting Review Panel, an advisory Board member of Bridges Ventures and a Vice President of Save the Children. Chair of The Co-operative Asset Management Limited. Also Executive Director of Co-operative Financial Services Limited, Co-operative Insurance Society Limited, and CIS General Insurance Limited.

Barry Tootell (BA (Hons), FCA). Age 48. Joined the Board in 2008. Chief Financial Officer. Qualified accountant with over 20 years' finance and control experience. Chair of CFS Management Services Limited. Also Executive Director of Co-operative Financial Services Limited, Co-operative Insurance Society Limited, and CIS General Insurance Limited.

The Directors submit their report, together with the audited financial statements, for the 52 weeks to 10 January 2009.

Business review

A review of the development and performance of the Bank and its operating subsidiaries during the financial year and any significant events since the year-end are set out on pages 10 to 17. The principal risks and uncertainties facing the Bank are set out in the risk management section on pages 57 to 83. The Bank's key financial and non-financial performance indicators are described on pages 18 and 19. Note 32 of the financial statements provides details of the Bank's principal subsidiaries and the nature of each organisation's business.

Principal activities

The Bank and its subsidiary undertakings provide an extensive range of banking and financial services in the United Kingdom.

Outlets

At 10 January 2009 the Bank had 128 outlets (2007: 121 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 pages 26 and 27. Barry Tootell was appointed to the Board with effect from 4 April 2008. Dick Parkhouse and Gerry Pennell were appointed to the Board with effect from 22 August 2008 when Stephan Pater resigned from the Board. Gerry Pennell resigned from the Board with effect from 3 October 2008.

Re-appointment of Directors

In accordance with the Articles of Association, Bob Burlton, Simon Butler, Kathryn Smith, and Piers Williamson retire by rotation. Bob Burlton and Piers Williamson offer themselves for re-election. They do not have service contracts with the Bank or any of its subsidiary undertakings. All Directors up for re-appointment continue to demonstrate commitment to their roles (see schedule of attendance on pages 33 and 34). The Notice of the Annual General Meeting at which the re-election of Directors will be proposed can be found on page 115.

Simon Butler and Kathryn Smith, along with Graham Bennett and Terry Morton, have indicated their desire not to seek re-election to the Co-operative Group Limited Board in June 2009 and so will also step down from the Bank Board at this time. The new Board of Co-operative Group Limited is due to meet on 17 June 2009 when it will elect, subject to FSA approval, four new Directors to the Bank Board.

Results and dividends

The profit before taxation and significant items was £70.4m (2007: £49.1m), an increase of £21.3m on 2007. The profit attributable to the ordinary shareholders amounted to £13.5m (2007: £3.2m). No dividends were paid during 2008. The Directors recommend that there will not be a final dividend payment on 29 May 2009.

Covered bonds

In August 2008 the Bank launched a 3 year £1 billion covered bond programme. The issue gave the Bank access to the Bank of England Special Liquidity Scheme (SLS) which allows banks to swap high quality mortgage book assets and other securities for UK Treasury Bills. Further information is provided in Note 13.
The Bank collateralised £1 billion of mortgage bank assets for £700 million UK Treasury Bills drawn down in two tranches of £250m and £450m on 29 January 2009 and 30 January 2009 respectively, which the Bank is utilising to further enhance its liquidity and manage liquidity stress scenarios.

Post balance sheet events

On 29 January 2009 the Bank announced it was proposing to merge with Britannia Building Society. The announcement followed the change in the law permitting co-operatives and mutuals to merge. The Co-operative Group Limited and Co-operative Financial Services Limited Boards approved the merger on 20 January 2009, however the merger is subject to the Britannia members agreement which is scheduled to take place in April 2009.

On 26 January 2009, the Bank issued £120 million of share capital to its parent company, Co-operative Financial Services Limited to reinforce its capital strength and give the Bank eligibility of the Government's Credit Guarantee Scheme. Given the Bank's strong retail funding position any guaranteed issuance is currently unlikely.

Directors and their interests

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

No Director had a beneficial interest in any shares in the Bank group or in Co-operative Group Limited, which is the ultimate holding organisation, or in any other entity controlled by Co-operative Group Limited.

There have been no changes in the Directors' shareholdings between the end of the financial year and 2 April 2009.

Employees

The Bank and its subsidiary undertakings employed 4,108 persons at 10 January 2009 (2007: 4,071). The weekly average number of persons was 3,990 (2007: 4,281) and their aggregate remuneration, before significant items, for the year was £108.2m (2007: £111.1m). The Bank, as part of CFS 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.

CFS, in Bank orientated activities, continues to consult and communicate with staff on customer, organisation and business performance issues, using staff publications, surveys, conferences, videos and both informal and formal consultations with Unite, which continues to be fully involved where organisational change and other issues affect staff.

Diversity

The Bank, as part of CFS, 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. Co-operative Financial Services Limited 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. Further guidance and information for employees on disability issues is available through Human Resources and on the employees intranet. The Bank recognises its responsibility for making 'reasonable adjustments' for new employees 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 20 and 21. In addition, the Co-operative Group Sustainability Report, which will be published towards the latter half of the 2009 financial year, describes how Co-operative Group Limited, CFS, Co-operative Insurance Society Limited, CIS General Insurance Limited and the Bank manage their social, ethical and environmental impacts.

Political and charitable donations

During the year, a CFS group company, CFS Management Services Limited, made donations (which exclude affinity card payments) of £0.3m on behalf of the Bank (2007: £0.3m made directly by the Bank) to United Kingdom charitable organisations. In addition payments of £0.2m (2007: £0.2m) were made by Co-operative Group Limited but funded by CFS on behalf of Bank customers, as part of the Bank's Customers Who Care campaigns. Additional costs associated with the Bank's community involvement are provided within the Co-operative Group 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. Based on valuations carried out by the Co-operative Group's internal property values their market value at the balance sheet data is £12.8m which is £6.2m higher than carrying value.

Supplier payment policy and practice

During the previous year the Bank ceased to pay suppliers directly as all supplies and services are sourced through CFS Management Services Limited, a fellow subsidiary of the CFS Group. A management charge is payable to cover the cost of these services. Consequently at 10 January 2009, the Bank had no purchases outstanding (2007: none).

Significant contracts

The Bank maintains a number of significant contracts with IT providers, cash handling entities and mailing service companies as well as with a CFS group company, CFS Management Services Limited which provides facilities and services for all CFS Group companies.

Financial statements

So far as the Directors are aware, there is no relevant audit information of which the Bank's auditors are unaware; and the Directors have taken all steps that they ought to have taken as Directors in order to make themselves aware of any relevant audit information and to establish that the Bank's auditors are aware of that information.

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 are required to prepare the group financial statements in accordance with IFRSs as adopted by the EU and applicable law and have elected to prepare the parent company financial statements on the same basis.

The financial statements are required by law to present fairly the financial position and the performance of the Bank and the Co-operative 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 Co-operative Group will continue in business. The Directors statement with respect to going concern is included on page 36.

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 Bank 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 Bank and the Group and to prevent and detect fraud and other irregularities.

The Directors are responsible for the maintenance and integrity of the corporate and financial information included on the company's website. Legislation in the UK governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

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
2 April 2009

UK Combined Code on Corporate Governance

For the year ended 10 January 2009, the Bank complied with the principles and provisions of the Combined Code on Corporate Governance appropriate to the structure of the Bank and its parent organisation Co-operative Financial Services Limited (CFS) and Co-operative Group Limited (the Co-operative Group), with the exception of the areas noted throughout the Corporate Governance Report.

Responsibility of the 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 Company, and in particular to:

- ensure that the Company's affairs are conducted and managed in accordance with its Memorandum and Articles, and the best interests of its stakeholders and in accordance with co-operative values and principles;
- agree objectives, policies and strategies and monitor the performance of executive management;
- 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 agree their terms of reference; and
- approve the delegated financial authorities.

The Board manages these matters at its regular Board and strategy meetings and details of attendance are noted on pages 33 and 34. It has met eleven times in 2008. The Board is scheduled to meet for eleven Board meetings and two strategy meetings in 2009.

Board balance and independence

The Board currently comprises thirteen Non-Executive Directors and four Executive Directors.

The Board has appointed four Independent Professional Non-Executive Directors as defined under the Combined Code: David Davies, Bob Newton, Piers Williamson and Graham Stow. David Davies is 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. Throughout the year the Bank Board met those code requirements on the independence of Directors.

With the exception of Graham Bennett and Bob Burlton, who represent corporate members of the Co-operative Group, Martyn Wates, who holds an executive appointment in the Co-operative Group, and Paul Hewitt who was, until 28 July 2007, Deputy Chief Executive of the Co-operative Group, the Board has determined the remaining five Non-Executive Directors: Simon Butler, Terry Morton, Kathryn Smith, Len Wardle and Stephen Watts, being Regional Directors of the Co-operative 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 and bring strong, independent judgement, 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.

Board procedures

Board and Committee papers are distributed at least one week in advance of meetings. This provides the opportunity for Directors to prepare fully 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 are 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 running of 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, and ensures Directors receive accurate, timely and clear information and that there is effective communication with shareholders.

Details of the Chair's professional commitments are included in the Chair's biography on page 26. 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. Each of these Committees has a role ensuring the effectiveness of the Company and its subsidiaries. A provision of the Code is that the terms of reference for the remuneration committee and the audit committee are available on the Company's website.

Remuneration and Appointments Committee

The CFS Remuneration and Appointments Committee meets as a joint Committee for CFS, Co-operative Insurance Society Limited (CIS), CIS General Insurance Limited (CISGIL), and the Bank. The Remuneration and Appointments Committee report is found on pages 37 to 42.

CFS Exposures Committee

The Committee comprises six members and is chaired by the Bank Chair, Graham Bennett. During the year the Committee comprised Kathryn Smith, Stephen Watts, Piers Williamson, David Anderson, Kevin Blake (who is not a Board Director), and Martyn Wates (who resigned from the Committee in June 2008).

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

- approve all Bank advances in excess of the delegated lending authority of the Chief Executive;
- review all decisions taken within the delegated authority of the Chief Executive or any individual Executive by way of Noting Returns;
- review and approve management actions on excess positions on lending exposures, which exceed the Chief Executive's discretion;
- review and approve management actions on excess positions on investment exposures, which exceed the Chief Executive's discretion;
- review and approve management actions on individual counterparty positions on the High Risk Exposures Return, where Credit Committee determines that these should be escalated;
- review and approve management actions on any other positions which the Credit Committee or the Heads of Advances/Advances support determine should be brought to its attention; and
- review and approve any reports required to be scheduled as part of Board policies.

CFS Audit & Regulatory Compliance Committee

The CFS Audit & Regulatory Compliance Committee meets as a joint committee for CFS, CIS, CISGIL, and the Bank. The Chair of the Committee in 2008 was Graham Stow, an Independent Non-Executive Director. Paul Hewitt was appointed as Chair of the Committee with effect from 1 January 2009. The other members of the Committee are Terry Morton, Kathryn Smith, and Bob Newton. Paul Hewitt brings recent and relevant financial experience.

The Committee met seven times during the financial year. Two of these occasions were joint meetings with the Co-operative Group Audit & Risk Committee to discuss the proposed merger with Britannia Building Society. The main responsibilities of the Committee are to:

- review and discuss with management and auditors the preliminary results, interim information and annual financial statements of the Bank and its subsidiaries before submission to the Board;
- review, prior to its consideration by the Board, the external auditor's reports to the Directors and Management's response;
- receive reports on activities and note the minutes of the CFS Risk Management Committee;
- consider any necessary disclosure implications of the process that has been applied by the Board to deal with material internal control aspects of any significant problems disclosed in the Financial Statements;
- obtain assurance that the Bank and its subsidiaries are compliant with relevant regulation;
- review and discuss, with the CFS Director of Compliance, the issues identified as a result of compliance work and how management is addressing these issues;
- monitor regulatory relationships, in particular, with the Financial Services Authority;
- review coordination between the internal and external auditors and, where relevant, the risk management functions;
- monitor and assess the role and effectiveness of the Internal Audit function;
- review the annual statements on internal control of the Bank and its subsidiaries and their compliance with the Combined Code or subsequent corporate governance guidance (as applicable) prior to consideration by the Board; and in particular where requested by the Board; and
- approve policies and review the adequacy of risk management activities in relation to operational risk.

During the year, the Committee has reviewed its own effectiveness.

CFS Risk Management Committee

The CFS Risk Management Committee meets as a joint committee for CFS, CIS, CISGIL, and the Bank. The Chair of CIS and CISGIL, Simon Butler, chairs the Committee. The other members of the Committee during the year were David Davies, Mike Fairbairn (who is not a Board Director), Paul Hewitt, Piers Williamson, Dick Parkhouse (who was appointed to the Board on 22 August 2008), and Barry Tootell (who was appointed to the Board and the Committee on 4 April 2008), and John Reizenstein who resigned from the Committee on 1 April 2008).

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

- to review and challenge the impact assessment of the strategic plan on the risk and capital profile of the Bank and its constituent elements;
- to review and challenge the risk appetite process with a focus on the overall organisational view of risk appetite;
- to monitor compliance with Board approved risk appetite;
- to approve mandates and portfolio limits in line with risk appetite, and monitor and review any breaches thereof;
- to assess the robustness of ICAAP/ICAS processes;
- to review and challenge the Bank Executive's recommendations on level of capital held in relation to how adequately it reflects the Bank's risk profile;
- to review and challenge the adequacy of risk management activities across the Bank managed by the Bank's Executive, including risk mitigation;
- to review and challenge the adequacy of the risk management process and systems in operation;
- to set standards for risk management processes and techniques, and benchmark against industry best practice on a regular basis; and
- monitor the credit risk performance of new and existing portfolios, against limits, and ensure any appropriate risk mitigation action or review of risk policies or limits is taken.

Attendance

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

Directors	Main Board	CFS Remuneration and Appointments Committee	CFS Exposures Committee
Number of meetings held	11	6	12
Graham Bennett	11(11)	6(6)	10(12)
Bob Burlton	11(11)	6(6)	–
Simon Butler	9(11)	5(6)	–
David Davies	10(11)	–	–
Paul Hewitt	11(11)	–	–
Terry Morton*	10(11)	5(5)	–
Bob Newton	11(11)	–	–
Kathryn Smith	11(11)	6(6)	10(12)
Graham Stow*	10(11)	6(6)	–
Len Wardle	11(11)	6(6)	–
Martyn Wates	11(11)	–	4(6)
Steve Watts	9(11)	–	11(12)
Piers Williamson	10(11)	–	11(12)
David Anderson	11(11)	–	10(12)
Dick Parkhouse	3(3)	–	–
John Reizenstein	11(11)	–	–
Barry Tootell	7(7)	–	–
Stephan Pater+	7(7)	–	–
Gerry Pennell+	1(1)	–	–

Directors	CFS Audit & Regulatory Compliance Committee	CFS Risk Management Committee
Number of meetings held	7	12
Graham Bennett	–	–
Bob Burlton	–	–
Simon Butler	–	11(12)
David Davies	–	10(12)
Paul Hewitt	7(7)	11(12)
Terry Morton*	7(7)	–
Bob Newton	5(7)	–
Kathryn Smith	7(7)	–
Graham Stow*	5(7)	–
Len Wardle	–	–
Martyn Wates	–	–
Steve Watts	–	–
Piers Williamson	–	8(12)
David Anderson	–	–
Dick Parkhouse	–	2(4)
John Reizenstein	–	1(2)
Barry Tootell	–	10(11)
Stephan Pater+	–	–
Gerry Pennell+	–	–

* Also members of the Co-operative Group Audit & Risk Committee
+ Resigned in 2008

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.

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 Company's expense in furtherance of their duties.

Directors and Officers' 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 and Officers. 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 Co-operative Group. The induction is appropriately tailored to their experience and background and includes an overview of the Bank and the wider Co-operative 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 the Executive, 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 new training framework is in the process of being developed to meet Directors' ongoing needs.

Performance evaluation

The Combined Code requires the Board to undertake a formal and rigorous annual evaluation of its own performance and that of its Committees and individual Directors. At the present time the Board collectively evaluates its performance, effectiveness, and commitment on an annual basis. The most recent process of annual evaluation started in December 2008 and the analysis was reported to the Board in March 2009.

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 decisions 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 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 Company.

The Executive of the financial services Boards of CFS, CIS, CISGIL and the Bank are organised under a single Executive Management framework.

Relations with shareholders

The Bank has two equity shareholders. The majority of shares are held by CFS, which is a wholly owned subsidiary of the Co-operative Group. The remainder of the shares are held directly 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.

Risk management

The Board and Executive management have the primary responsibility for identifying the key business risks facing the organisation. The CFS Risk Management Framework, which is approved and reviewed by the Board, outlines the approach taken to ensure a robust risk management process is in place throughout the organisation and is regularly reviewed. The framework includes an ongoing process for identifying, evaluating and managing significant risks and has been in place for the year under review and up to the date of the approval of the Annual Report and Accounts.

The Board accepts that there are risks which could impact on achieving the Bank's business objectives, but endeavours through positive risk management strategies as outlined in the Risk Management Framework, to manage these in a manner that optimises returns within the confines of the business' risk appetite, whilst protecting shareholders' interests and reserves.

For further information on the Bank's approach to risk management see pages 57 to 83.

Internal control

The Board has overall responsibility for the Bank's system of internal controls which aim to ensure effective and efficient operations, quality of internal and external reporting, safeguarding of the Company's assets and compliance with laws and regulations. Whilst recognising that the system is designed to manage rather than eliminate risk of failure to achieve business objectives, it can only provide reasonable and not absolute assurance against material misstatement or loss.

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 governance structure with clear lines of responsibility, delegation of authority and reporting requirements;
- checks and balances to ensure that business processes operate efficiently, reducing the risk posed to the organisation whilst adhering to organisational values;
- 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;
- a Code of Business Conduct covering relations with customers, shareholders, employees, suppliers, community and competitors;
- a whistleblowing policy and procedure which provides for any employee to report, in confidence, suspected serious malpractice; and
- Internal Audit, Risk and Compliance functions that review the system of internal control.

During 2008, a significant control identification and improvement exercise was completed, resulting in the launch of a Control Self Assessment (CSA) tool. This is designed to fully support the annual review of the effectiveness of the system of internal control, and will further embed the robustness of the internal control environment to enable a process of continual improvement.

External audit

One of the duties of the CFS Audit & Regulatory Compliance Committee is to make recommendations to the Co-operative Group Audit & 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 following a competitive tender exercise. At its meeting in September 2008 the Co-operative Group Audit & Risk Committee deferred further consideration of a tender until 2010 due to the high level of continuing change within the Group businesses.

Details of the amounts paid to the external auditors during the year for audit and other services are set out in note 2 on page 88.

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 Co-operative Group Audit & Risk Committee receives at each meeting a report providing details of assignments and related fees carried out by the external auditor 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 & Regulatory Compliance 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 function, which derives its authority from the Board through the CFS Audit & Regulatory Compliance Committee. Its primary role is to provide assurance over the adequacy and effectiveness of the internal control framework including risk management practices.

Internal Audit seeks to discharge the responsibilities set down in its charter by completing a risk based internal audit plan, reviewing the processes which ensure that the top business risks are effectively managed.

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.

Internal Audit reports are submitted to, and significant issues discussed at, the CFS Audit & Regulatory Compliance Committee. Full details of the operation of this Committee can be found on page 32.

Information and communication

Communication takes place with all key stakeholders through a variety of media including the Sustainability Report produced by the Co-operative Group. 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.

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 (the 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 2006).

The Bank Board comprises Non-Executive Directors including Independent Professional Non-Executive Directors, a Professional Non-Executive Director and Executive Directors, all appointed by the Co-operative Group Board.

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

This report will be put to an advisory vote of shareholders of the Company at its Annual General Meeting, which will be held on 6 June 2009.

Introduction

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

- a description of the role of the CFS Remuneration & 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 2008 financial year.

The CFS Remuneration & Appointments Committee meets as a combined Committee for CFS 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 the Executives and approve the principal terms and conditions of employment of such Executives;
- review remuneration using comparisons against the agreed market policy for the Executive;
- make recommendations on Executive appointments and the terms and conditions relating to these;
- approve any relevant 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 in relation to the Co-operative Group Pension (Average Career Earnings) Scheme and any other retirement benefit scheme within the Group and advise the Board of them as appropriate.

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

At the end of 2008, the Committee comprised seven members. The members are Bob Burlton as CFS Chair, together with Graham Bennett (Bank Chair), Simon Butler, Terry Morton, Kathryn Smith, Graham Stow, and Len Wardle. The Board believes that all members of the Committee are independent for the purposes of reviewing remuneration matters. The CFS Chief Executive and the Human Resources Director also attended the meetings of the Committee, except when their own remuneration was being considered. Other individuals are invited to attend for specific agenda items when necessary. The Committee works with the Co-operative Group Remuneration & Appointments Committee in ensuring consistency, where appropriate, across the wider Co-operative Group.

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 six times in the period under review.

To ensure that it receives independent advice on remuneration matters, the Committee retained Hewitt New Bridge Street as its advisers during 2008 to provide advice solely on remuneration matters. Hewitt New Bridge Street has supplied advice on remuneration survey data, market trends and pensions matters, including incentive schemes. Other than specialist advice in relation to remuneration matters, Hewitt New Bridge Street does not provide other services to the Bank. Solicitors, Addleshaw Goddard, were also retained to provide 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 business and individual performance and the strengthening of co-operative values which include a strong belief in stewardship of all the Society's resources and, therefore, ensures that Management are not rewarded for the assumption of undue risk; and
- ensuring that the interests and pay practices of the Executive Directors are aligned across the Society.

Policy on Directors' remuneration (continued)

The current policy is to pay Executive Directors, who also sit on the CFS Board, basic salaries around the market median, when compared with other organisations of comparable size and complexity, and also organisations in the same business sector. The Committee supports the principle of performance-related pay and operates an annual incentive plan and a long term incentive plan but does not consider it appropriate to follow the quantum available in PLCs. Accordingly, the amounts payable under these plans are lower than in comparable PLCs.

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. Accordingly, the Committee keeps the Bank's remuneration policy under review.

The last year has seen unprecedented turmoil in the financial markets which has had a profound impact on many of our competitors. However, the Society has remained resilient through the period with the combination of the restructuring steps taken in the last three years and a robust model based on sound co-operative principles (which avoid undue risk taking or reliance on a single business stream) having proved to be successful. In particular, the absence of highly leveraged incentive plans (when compared with practice in the quoted sector) has ensured that the Executive has not been encouraged to accept undue risk as a means of securing personal reward.

The Committee notes that many of the practices already adopted at the Society have been endorsed by the Financial Services Authority (FSA) in its Code of Practice on remuneration policies. However, the Committee continues to strive for further improvements in its executive remuneration arrangements as best practice evolves.

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. Basic 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), and business and individual performance during the financial year. The normal salary review date for Executive Directors is at the start of each financial year in January. Basic 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 40.

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 plan for the 2008 financial year was 35% of basic salary for Executive Directors, including the Chief Executive. Under the incentive plan the maximum potential for Executive Directors (including the Chief Executive) is 60% of basic salary for substantially exceeding targets. These percentages remain unchanged for the 2009 plan.

For Executive Directors, targets in the bonus year 2008 (paid 2009) are constructed so that 75% of any payout relates to financial measures, these being Total Shareholder Result, Life & Savings New Business Profit ('NBP') and Life & Savings Maintenance Expenses, with the remaining 25% being based on colleague and customer satisfaction.

For the CFS Chief Executive, the ratio was 90% against CFS performance, and 10% based on wider Co-operative Group initiatives for the whole of 2008.

For 2009, the same arrangements will apply for the CFS Chief Executive's bonus.

The payments for the annual incentive plan in respect of the year 2008 are reflected in Table 1 within 'Performance Related Pay'.

3. Long Term Incentive Plan

A medium term incentive plan was initially introduced in 2003 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. 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. The fourth three-year period of operation of the plan was 2006-2008 with potential payment in 2009. The target annualised payment level under the plan for 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.

Following a review of incentives, this medium term incentive plan is being phased out with the plans that have started, i.e. 2006-2008 and 2007-2009, continuing for their three-year term being replaced by a new long term incentive plan from the start of 2008. The 2006-2008 plan has been completed and any payments due are shown in Table 1 within 'Performance Related Pay Medium Term' .

The review of incentives, led by Hewitt New Bridge Street, resulted in a new long term incentive plan for 2008 and beyond being approved. The plan will be measured on the achievement of Financial Performance targets together with a Balanced Scorecard, i.e. customer satisfaction, growing colleague engagement and corporate reputation, over a fixed three-year period starting 2008-2010 with potential payment in 2011. The 2009-2011 plan with potential payment in 2012 will have similar arrangements. For Executive Directors, the threshold payment level, subject to performance conditions being met, is 16.7% of basic salary, with a maximum payment of up to 50% of salary for substantially exceeding targets. It is envisaged that equivalent awards will be made annually thereafter.

The main components of Executive Directors' remuneration are: (continued)

4. Service Agreements

It is the Bank's policy for the notice period in Executive Directors' Service Contracts not to exceed one year. Executive Directors have consistent contracts that are terminable by up to one year's notice by the organisation and six months' notice by the individual. In the event of termination, any payments due to an Executive Director would be based on this. 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 2008. The dates of existing contracts or dates of appointment are shown in Table 1.

In normal circumstances, it is the Committee's policy to apply service contracts for any newly recruited Executive Directors in a similar form to the model that has been developed for existing Executive Directors.

5. Share Options

Senior executives of most companies get a payout under an executive share option scheme. Because of the co-operative nature of the business it is not appropriate to operate a share option scheme.

6. 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. Any fees received from such a role will normally be paid to the Bank, CFS or the Co-operative Group.

At this time, none of the Executives hold any Non-Executive Directorships with companies outside of the Co-operative Group.

7. Pensions

The Financial Services businesses participate in the Co-operative Group Pension (Average Career Earnings) Scheme (the PACE Scheme), which is a defined benefit pension scheme available to all employees. The PACE Scheme, which is a registered occupational pension scheme, provides pensions based on 1/60th of average pensionable earnings, re-valued for inflation for each year of pensionable service from 6 April 2006. Accrued benefits as at 5 April 2006 continue to be linked to final pensionable salary at a member's date of leaving or retirement, whichever is earlier. Pensions are also payable to dependents on death and a lump sum is payable if death occurs in service.

Members of the PACE Scheme currently contribute 6% of their pensionable salary towards the cost of providing pension benefits with the employer paying the balance.

Executive Directors have the facility of opting out of future pension accrual under the PACE Scheme when the value of their accrued pension benefits reaches the lifetime allowance under the tax rules in favour of a non-pensionable salary supplement of 16% of basic salary in lieu of pension provision. John Reizenstein had previously opted out of the PACE Scheme on this basis and is entitled to a deferred pension. He receives a salary supplement of 16% of basic salary.

David Anderson and Stephan Pater have previously elected not to join the PACE Scheme and were each paid a salary supplement of 16% of basic salary. Gerry Pennell contributed to the PACE Scheme until he left on 3 October 2008 when he became entitled to a deferred pension.

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

Additional details are available in Table 2.

Non-Executive Directors

All the Non-Executive Directors are appointed, and their Directors' fees are determined and paid, by the Co-operative Group. In October 2007, the Co-operative Group approved a fee of £104,100 per annum for the CFS Chair (Bob Burlton) with effect from October 2007 and an additional payment of £10,000 per annum to the Chair of the CFS Audit & Risk Committee (Graham Stow) with effect from November 2007. Details of the Directors' fees are shown in Table 3.

Paul Hewitt became a Professional Non-Executive Director on 29 July 2007 having previously been a Non-Executive Director when he was Deputy Chief Executive of the Co-operative Group.

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

- David Davies, who 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;
- Bob Newton, who was appointed to the Board on 1 August 2007;
- Graham Stow, who was appointed to the Board on 4 March 2003; and
- Piers Williamson, who was appointed to the Board on 1 July 2005.

Details of their remuneration are also shown in Table 3.

Non-Executive Directors (continued)

Of the Non-Executive Directors, the Independent Professional Non-Executive Directors and the Professional Non-Executive Director 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 an agreement effective up to 31 May 2009 with approval of the Co-operative Group Board in September 2007;
- David Davies holds an agreement effective up to 31 May 2010 with approval of the Co-operative Group Board following his appointment as Senior Independent Director, with effect from 23 February 2005;
- Bob Newton holds a three-year agreement, effective up to 31 July 2010;
- Piers Williamson holds an agreement effective up to 31 October 2009; and
- Paul Hewitt holds a three-year agreement, effective up to 28 July 2010.

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. It is normal policy of the Board not to allow an Independent Professional Non-Executive Director to serve for more than 9 years in aggregate.

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

None of the above Independent Professional Non-Executive Directors are Directors of the Co-operative Group or members of any Co-operative Group pension scheme or incentive plan.

Table 1 – Executive Directors' Emoluments

	Date of service contract or appointment	Basic Salary £'000	Other Supplements (2) £'000	Performance Related Pay Annual £'000	Benefits in Kind £'000	Total relating to 2008 £'000	Performance Related Pay Medium Term £'000	2008 Emoluments £'000	2007 Total Emoluments £'000
David Anderson (1) (4) (7)	1 June 2005	**590**	**104**	**183**	**9**	**886**	**135**	**1,021**	1,278
Dick Parkhouse (1) (5)	2 October 2006	**117**	**7**	**29**	**–**	**153**	**24**	**177**	–
Stephan Pater (1) (4) (8)	1 March 2005	**204**	**66**	**–**	**–**	**270**	**–**	**270**	574
Gerry Pennell (1) (5) (9)	2 February 2004	**59**	**4**	**–**	**–**	**63**	**–**	**63**	–
John Reizenstein (1) (4)	6 January 2005	**348**	**74**	**101**	**–**	**523**	**80**	**603**	619
Barry Tootell (1) (3) (5) (6)	4 April 2008	**259**	**76**	**97**	**100**	**532**	**–**	**532**	–
		1,577	**331**	**410**	**109**	**2,427**	**239**	**2,666**	2,471
Former Directors who served the Bank in 2005, 2006 and 2007		**–**	**–**	**–**	**–**	**–**	**–**	**–**	283
Compensation for loss of office (10)		**–**	**–**	**–**	**–**	**–**	**–**	**580**	405
Amounts attributable to fellow subsidiaries		**(902)**	**(153)**	**(196)**	**(62)**	**(1,313)**	**(197)**	**(1,510)**	(1,797)
		675	**178**	**214**	**47**	**1,114**	**42**	**1,736**	1,362

Notes

(1) 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, CIS and CISGIL. Of these emoluments, the following have been recharged to fellow group companies in respect of services as a Director or Senior Manager of CIS, CFS and CISGIL:

David Anderson	57%
Dick Parkhouse	57%
Stephan Pater	57%
John Reizenstein	58%
Gerry Pennell	56%
Barry Tootell	57%

(2) Other Supplements includes a car allowance, which is paid with basic salary, but is not pensionable.
(3) Barry Tootell's Other Supplements includes a payment of £57k relating to a one-off payment for a disturbance allowance.
(4) The other supplements figures for David Anderson, Stephan Pater and John Reizenstein include a salary supplement in lieu of pension provision.
(5) Barry Tootell was appointed on 4 April 2008 and Dick Parkhouse and Gerry Pennell were both appointed on 22 August 2008.
(6) The Benefits in Kind total for Barry Tootell relates to a one-off payment for relocation expenses incurred in 2008.
(7) David Anderson's bonus figures relates to CFS performance which accounts for 90% of his bonus eligibility. The remaining 10% relates to Co-operative Group initiatives. This bonus amount will be approved and paid for by the Co-operative Group.
(8) Stephan Pater resigned as an Executive Director on 22 August 2008.

Notes continued

(9) Gerry Pennell resigned as an Executive Director on 3 October 2008.

(10) Compensation paid for loss of office was in respect to Stephan Pater for 2008 and Craig Shannon for 2007.

Table 2 – Pension details of the Executive Directors

	Years of service	Total accrued pension at 10 January 2009 (1) £'000	Increase in accrued pension during the year £'000	Increase in accrued pension during the year (net of inflation) £'000	Transfer value of previous column at 10 January 2009 net of members' contributions £'000	Transfer value of total accrued pension at 12 January 2008 (3) £'000	Transfer value of total accrued pension at 10 January 2009 (3) £'000	Increase in transfer values net of members' contributions £'000
David Anderson (4)	3	**–**	**–**	**–**	**–**	–	**–**	–
Dick Parkhouse (2)	2	**8**	**4**	**4**	**52**	48	**126**	61
Stephan Pater (4)	3	**–**	**–**	**–**	**–**	–	**–**	–
Gerry Pennell (2) (7)	5	**24**	**5**	**5**	**49**	203	**333**	116
John Reizenstein (5)	5	**5**	**–**	**–**	**–**	62	**86**	24
Barry Tootell (2) (6)	–	**4**	**4**	**4**	**26**	–	**42**	26

Notes

(1) The total accrued pension is that which would be paid annually on retirement at normal retirement age based on service to 10 January 2009 and includes any transferred-in benefits as appropriate. Under the terms of their contracts, existing Executive Directors at 17 January 2007 may take these benefits from age 60 and new Executive Directors after 17 January 2007 may take these benefits from age 65. The transfer values in the table above have been calculated on this basis.

(2) Members of the PACE Scheme have the option of paying additional voluntary contributions within the tax rules. Neither these contributions nor the benefits arising from them are shown in the above table.

(3) All transfer values at year-end have been calculated in accordance with the current transfer value method and basis in force for the PACE Scheme. This is set by the Trustee, after taking actuarial advice, to be consistent with the requirements of legislation and the rules of the scheme. The transfer value basis has been revised during the year and this accounts for some of the increase in the transfer values shown.

(4) David Anderson and Stephan Pater were each paid a non-pensionable salary supplement of 16% of basic salary in lieu of pension provision.

(5) John Reizenstein opted out of joining the PACE Scheme on 6th April 2006 and became entitled to a deferred pension. He was paid a non-pensionable salary supplement of 16% of basic salary in lieu of pension provision. Deferred pensions are revalued under the PACE Scheme rules but no account has been taken of this in the above table.

(6) Barry Tootell joined the PACE Scheme on 1 April 2008.

(7) Gerry Pennell resigned as an Executive Director on 3 October 2008. He became entitled to a deferred pension under the PACE Scheme rules when he left the Scheme at the same date. The age, service, deferred pension and transfer value figures are calculated at that date.

Table 3 – Non-Executive Directors' Remuneration

Non-Executive Directors	Date Appointed	2008 Fee £'000	2007 Fee £'000
Graham Bennett (1)	**1989**	**16**	17
Simon Butler (1)	**2003**	**16**	17
Terry Morton	**2006**	**10**	9
Kathryn Smith	**2001**	**10**	9
Len Wardle	**2006**	**10**	9
Martyn Wates (2)	**2007**	**–**	–
Stephen Watts	**2006**	**10**	9
Bob Burlton (3)	**2004**	**104**	21
Professional Non-Executive Directors			
Graham Stow (4)	**2003**	**62**	51
David Davies	**2003**	**58**	55
Paul Hewitt (5)	**2003**	**53**	21
Bob Newton	**2007**	**53**	22
Piers Williamson	**2005**	**53**	48

Notes

(1) Graham Bennett and Simon Butler's fees for 2007 were based on a 53 week year whereas 2008 was a 52 week year. Directors' fees are broken down over a weekly amount and have been rounded up resulting in the difference between the 2007 and 2008 reported figures.

(2) Martyn Wates, Chief Financial Officer of the Co-operative Group was appointed as a Non-Executive Director of CFS on 13 November 2007 and is paid by the Co-operative Group in respect of this appointment.

(3) As Chair of CFS, Bob Burlton received fees direct with effect from 27 October 2007 as a result of a change in policy approved by Co-operative group members. Previously a payment was also made to his employer for releasing him for Co-operative Group and CFS duties.

(4) Graham Stow received a £10,000 fee (included in the figures in Table 3) for being Chair of CFS Audit & Regulatory Compliance Committee until 31 December 2008.

(5) Paul Hewitt became Chair of CFS Audit & Regulatory Compliance Committee on 1 January 2009 so now receives a £10,000 fee.

By Order of the Board
Bob Burlton, Chair, CFS Remuneration & Appointments Committee
Graham Bennett, Chair, The Co-operative Bank
2 April 2009

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

We have audited the Consolidated and Bank financial statements (the 'financial statements') of The Co-operative Bank p.l.c. for the year ended 10 January 2009 which comprise the Consolidated Income Statement, the Consolidated and Bank Balance Sheets, the Consolidated and Bank Cash Flow Statements, the Consolidated and Bank 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 whether the financial statements have been properly prepared in accordance with the Companies Act 1985 and, as regards the Consolidated financial statements, Article 4 of the IAS Regulation. We also report to you whether in our opinion the information given in the Directors' Report is consistent with the financial statements. The information given in the Directors' Report includes that specific information presented in the Business and Financial Review that is cross referred from the Business Review section of the Directors' Report.

In addition we report to you if, in our opinion, the Bank 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.

We review whether the Corporate Governance Statement reflects the Bank's compliance with the nine provisions of the 2006 Combined Code specified for our review by the Listing Rules of the Financial Services Authority, and we report if it does not. We are not required 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 the 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 Bank'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 consolidated 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 10 January 2009 and of its profit for the year then ended;
- the Bank 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 Bank's affairs as at 10 January 2009;
- the financial statements have been properly prepared in accordance with the Companies Act 1985 and, as regards the consolidated financial statements Article 4 of the IAS Regulation; and
- the information given in the Directors' Report is consistent with the financial statements.

KPMG Audit Plc
Chartered Accountants
Registered Auditor
St James Square
Manchester M2 6DS
2 April 2009

Consolidated income statement

For the year ended 10 January 2009
All amounts are stated in £m unless otherwise indicated

	Notes	**Before significant items 2008**	**Significant items 2008**	**After significant items 2008**	Before significant items 2007	Significant items 2007	After significant items 2007
Interest and similar income		**830.2**	**–**	**830.2**	800.0	–	800.0
Interest expense and similar charges		**(455.9)**	**–**	**(455.9)**	(465.2)	–	(465.2)
Net interest income	4	**374.3**	**–**	**374.3**	334.8	–	334.8
Fee and commission income		**216.5**	**–**	**216.5**	216.5	–	216.5
Fee and commission expense		**(35.6)**	**–**	**(35.6)**	(33.3)	–	(33.3)
Net fee and commission income	5	**180.9**	**–**	**180.9**	183.2	–	183.2
Net trading income	6	**4.9**	**–**	**4.9**	5.5	–	5.5
Other operating income	16	**9.3**	**–**	**9.3**	–	–	–
Operating income		**569.4**	**–**	**569.4**	523.5	–	523.5
Operating expenses	7	**(336.3)**	**(47.1)**	**(383.4)**	(339.3)	(38.0)	(377.3)
Financial Services Compensation Scheme levy	25	**(10.5)**	**–**	**(10.5)**	–	–	–
Operating profit before impairment losses		**222.6**	**(47.1)**	**175.5**	184.2	(38.0)	146.2
Impairment losses on loans and advances	13	**(96.8)**	**–**	**(96.8)**	(102.0)	–	(102.0)
Impairment losses on investments	14	**(50.7)**	**–**	**(50.7)**	(31.8)	–	(31.8)
Operating profit		**75.1**	**(47.1)**	**28.0**	50.4	(38.0)	12.4
Profit based payments to members of the Co-operative Group		**(4.7)**	**–**	**(4.7)**	(1.3)	–	(1.3)
Profit before taxation		**70.4**	**(47.1)**	**23.3**	49.1	(38.0)	11.1
Income tax	9	**(19.4)**	**13.4**	**(6.0)**	(16.6)	11.4	(5.2)
Profit for the financial year		**51.0**	**(33.7)**	**17.3**	32.5	(26.6)	5.9
Attributable to:							
Equity shareholders	10	**47.2**	**(33.7)**	**13.5**	29.8	(26.6)	3.2
Minority interests		**3.8**	**–**	**3.8**	2.7	–	2.7
		51.0	**(33.7)**	**17.3**	32.5	(26.6)	5.9
Earnings per share	11	**4.29p**	**(3.06)p**	**1.23p**	2.71p	(2.42)p	0.29p

2008 and 2007 significant items relate to non-recurring expenditure associated with a Group programme of restructuring

The related notes on pages 50 to 111 form part of these financial statements

At 10 January 2009
All amounts are stated in £m unless otherwise indicated

	Notes	**2008**	2007
Assets			
Cash and balances at central banks		**164.7**	172.9
Loans and advances to banks	12	**1,886.7**	1,204.0
Loans and advances to customers	13	**10,306.3**	9,009.0
Debt securities	14	**2,231.7**	2,430.9
Derivative financial instruments	15	**203.0**	88.2
Equity shares	16	**13.0**	8.8
Intangible fixed assets	17	**2.3**	5.2
Property, plant and equipment	18	**59.6**	79.8
Other assets	19	**31.2**	16.5
Prepayments and accrued income		**65.6**	71.6
Total assets		**14,964.1**	13,086.9
Liabilities			
Deposits by banks	20	**1,072.3**	661.3
Customer accounts	21	**11,908.8**	10,559.5
Debt securities in issue	22	**568.0**	535.8
Derivative financial instruments	15	**117.9**	92.3
Other borrowed funds	23	**358.4**	358.1
Other liabilities	24	**91.7**	103.8
Accruals and deferred income		**22.3**	37.5
Provision for liabilities	25	**15.8**	9.4
Current tax liabilities		**1.2**	6.1
Deferred tax liabilities	26	**27.0**	6.2
Total liabilities		**14,183.4**	12,370.0
Capital and reserves attributable to the Bank's equity holders			
Ordinary share capital	28	**55.0**	55.0
Share premium account	28	**8.8**	8.8
Retained earnings	29	**641.5**	627.6
Other reserves	29	**42.5**	(1.4)
		747.8	690.0
Minority interests	29	**32.9**	26.9
Total equity		**780.7**	716.9
Total liabilities and equity		**14,964.1**	13,086.9

Approved by the Board on 2 April 2009 and signed on its behalf by:

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

Bank balance sheet

At 10 January 2009
All amounts are stated in £m unless otherwise indicated

	Notes	2008	2007
Assets			
Cash and balances at central banks		**164.7**	172.9
Loans and advances to banks	12	**1,897.5**	1,211.2
Loans and advances to customers	13	**11,169.8**	8,914.4
Debt securities	14	**1,810.2**	1,985.7
Derivative financial instruments	15	**233.4**	88.5
Equity shares	16	**13.0**	8.8
Shares in group undertakings	32	**969.3**	2.7
Intangible fixed assets	17	**1.5**	4.3
Property, plant and equipment	18	**53.9**	74.0
Current tax assets		**2.5**	–
Other assets	19	**31.0**	16.4
Prepayments and accrued income		**56.8**	44.9
Total assets		**16,403.6**	12,523.8
Liabilities			
Deposits by banks	20	**1,072.3**	661.3
Customer accounts	21	**13,388.7**	10,068.1
Debt securities in issue	22	**568.0**	535.8
Derivative financial instruments	15	**123.2**	92.8
Other borrowed funds	23	**358.4**	358.1
Other liabilities	24	**109.6**	102.5
Accruals and deferred income		**30.3**	32.5
Provision for liabilities	25	**14.7**	8.8
Current tax liabilities		**–**	2.9
Deferred tax liabilities	26	**22.5**	0.7
Total liabilities		**15,687.7**	11,863.5
Capital and reserves attributable to the Bank's equity holders			
Ordinary share capital	28	**55.0**	55.0
Share premium account	28	**8.8**	8.8
Retained earnings	29	**610.7**	597.9
Other reserves	29	**41.4**	(1.4)
Total equity		**715.9**	660.3
Total liabilities and equity		**16,403.6**	12,523.8

Approved by the Board on 2 April 2009 and signed on its behalf by:

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

The related notes on pages 50 to 111 form part of these financial statements

All amounts are stated in £m unless otherwise indicated

	Group 2008	Group 2007	Bank 2008	Bank 2007
Cash flow hedges:				
Effective portion of cash flow hedges transferred to equity	**86.2**	29.0	**81.7**	28.1
Cash flow hedges transferred to profit or loss	**0.8**	(0.5)	**0.8**	(0.5)
Available for sale investments:				
Net movements through equity	**(25.1)**	3.4	**(26.3)**	3.0
Valuation gains/(losses) transferred to profit or loss on sale	**2.2**	(0.2)	**2.2**	(0.2)
Net movement in pension fund deficit due to actuarial gains and losses	**0.5**	(0.4)	**0.5**	(0.4)
Tax on items taken directly to equity	**(17.2)**	(9.6)	**(15.7)**	(9.2)
Net income and expense recognised directly in equity	**47.4**	21.7	**43.2**	20.8
Net profit/(loss) – equity shareholders	**13.5**	3.2	**12.4**	(1.1)
Net profit – minority interests	**3.8**	2.7	**–**	–
Total recognised income and expense for the financial year	**64.7**	27.6	**55.6**	19.7
Total recognised income and expense for the year is attributable to:				
Equity shareholders	**57.8**	24.2	**55.6**	19.7
Minority interests	**6.9**	3.4	**–**	–
	64.7	27.6	**55.6**	19.7

Amounts shown above are net of tax

Consolidated cash flow statement

For the year ended 10 January 2009
All amounts are stated in £m unless otherwise indicated

	2008	2007
Cash flows from operating activities		
Profit before taxation	**23.3**	11.1
Adjustments for:		
Decrease in prepayments and accrued income	**6.0**	19.9
Decrease in accruals and deferred income	**(11.0)**	(37.4)
Interest payable in respect of subordinated liabilities	**17.5**	19.5
Effect of exchange rate movements	**(10.9)**	(5.2)
Effect of non-cash pension costs	**0.1**	0.1
Impairment losses on loans and advances	**96.8**	102.0
Impairment losses on investments	**50.7**	31.8
Depreciation and amortisation	**20.1**	22.7
Interest amortisation	**(12.2)**	(4.6)
Amortisation of investments	**(0.2)**	(1.0)
(Profit)/loss on sale of investments	**(3.1)**	0.3
Loss on disposal of fixed assets	**2.4**	7.4
Preference dividend	**5.6**	5.6
	185.1	172.2
Increase/(decrease) in deposits by banks	**348.3**	(53.7)
Increase in customer accounts	**1,349.3**	1,015.2
Increase/(decrease) in debt securities in issue	**32.2**	(577.5)
(Increase)/decrease in loans and advances to banks	**(297.0)**	145.0
Increase in loans and advances to customers	**(1,381.9)**	(958.9)
Net movement of other assets and other liabilities	**(23.3)**	26.2
Income tax paid	**(8.4)**	(19.1)
Net cash flows from operating activities	**204.3**	(250.6)
Cash flows from investing activities		
Purchase of property, equipment and software	**(0.3)**	(19.0)
Proceeds from sale of property and equipment	**0.9**	0.6
Purchase of debt securities	**(14,074.2)**	(10,304.5)
Proceeds from sale and maturity of debt securities	**14,156.8**	11,108.6
Net cash flows from investing activities	**83.2**	785.7
Cash flows from financing activities		
Interest paid in respect of subordinated loanstock	**(17.3)**	(19.3)
Repayment of subordinated loanstock	**–**	(30.0)
Ordinary share dividends paid	**–**	(9.0)
Preference dividends paid	**(5.6)**	(5.6)
Dividends paid to minority shareholders in subsidiary undertaking	**(0.9)**	(0.9)
Net cash flows from financing activities	**(23.8)**	(64.8)
Increase in cash and cash equivalents	**263.7**	470.3
Cash and cash equivalents at the beginning of the financial year	**2,070.2**	1,599.9
Cash and cash equivalents at the end of the financial year	**2,333.9**	2,070.2
Cash and balances with central banks	**164.7**	172.9
Loans and advances to banks (note 12)	**1,589.7**	1,204.0
Short term investments (note 14)	**579.5**	693.3
	2,333.9	2,070.2

The related notes on pages 50 to 111 form part of these financial statements

All amounts are stated in £m unless otherwise indicated

	2008	2007
Cash flows from operating activities		
Profit before taxation	**16.0**	1.0
Adjustments for:		
(Increase)/decrease in prepayments and accrued income	**(11.8)**	34.4
Increase/(decrease) in accruals and deferred income	**0.2**	(35.6)
Interest payable in respect of subordinated liabilities	**17.5**	19.5
Effect of exchange rate movements	**(10.9)**	(5.2)
Effect of non-cash pension costs	**0.1**	0.1
Impairment losses on loans and advances	**95.9**	102.0
Impairment losses on investments	**50.7**	31.8
Depreciation and amortisation	**19.6**	22.0
Interest amortisation	**(12.1)**	(4.5)
Amortisation of investments	**(0.2)**	(1.0)
(Profit)/loss on sale of investments	**(3.1)**	0.3
Loss on disposal of fixed assets	**2.4**	7.4
Preference dividend	**5.6**	5.6
	169.9	177.8
Increase/(decrease) in deposits by banks	**348.3**	(53.7)
Increase in customer accounts	**3,320.6**	948.8
Increase/(decrease) in debt securities in issue	**32.2**	(577.5)
(Increase)/decrease in loans and advances to banks	**(297.0)**	145.0
Increase in loans and advances to customers	**(2,339.2)**	(960.0)
Net movement of other assets and other liabilities	**(33.0)**	26.9
Income tax paid	**(4.0)**	(16.0)
Net cash flows from operating activities	**1,197.8**	(308.7)
Cash flows from investing activities		
Purchase of property, equipment and software	**–**	(18.5)
Proceeds from sale of property and equipment	**0.9**	0.6
Purchase of shares in group undertaking	**(966.7)**	–
Purchase of debt securities	**(12,248.7)**	(9,387.4)
Proceeds from sale and maturity of debt securities	**12,306.6**	10,252.7
Net cash flows from investing activities	**(907.9)**	847.4
Cash flows from financing activities		
Interest paid in respect of subordinated loanstock	**(17.3)**	(19.3)
Repayment of subordinated loanstock	**–**	(30.0)
Ordinary share dividends paid	**–**	(9.0)
Preference dividends paid	**(5.6)**	(5.6)
Dividends from associated undertakings	**0.3**	0.3
Net cash flows from financing activities	**(22.6)**	(63.6)
Increase in cash and cash equivalents	**267.3**	475.1
Cash and cash equivalents at the beginning of the financial year	**2,077.4**	1,602.3
Cash and cash equivalents at the end of the financial year	**2,344.7**	2,077.4
Cash and balances with central banks	**164.7**	172.9
Loans and advances to banks (note 12)	**1,600.5**	1,211.2
Short term investments (note 14)	**579.5**	693.3
	2,344.7	2,077.4

The Co-operative Bank p.l.c. is registered in England and Wales under the Companies Act.

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 International Financial Reporting Standards (IFRSs) as issued by the International Accounting Standards Board (IASB), and International Financial Reporting Interpretations Committee (IFRIC) guidance as adopted by the European Union. 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'.

Going concern

The Group's business activities together with its financial position, and the factors likely to affect its future development and performance are set out in the Business Review on pages 10 to 17. In addition, the risk management section on pages 57 to 83 includes the Group's objectives, policies and processes for managing its liquidity risk, details of financial instruments and hedging activities, and its exposure to credit risk and liquidity risk. The capital management section provides information on the Bank's capital policies and capital resources.

In common with many financial institutions, the Group meets its day-to-day liquidity requirements through managing both its retail and wholesale funding sources, and is required to maintain a sufficient buffer over regulatory capital requirements in order to continue to be authorised to carry on its business. The Group's forecasts and objectives, taking into account a number of potential changes in trading performance and funding retention, show that the Group should be able to operate at adequate levels of both liquidity and capital, for the foreseeable future. The Group has also considered a number of stress tests on capital and liquidity, including and excluding the proposed Britannia merger, and these provide assurance that the Bank is sufficiently capitalised and is comfortably in excess of liquidity stress tests. Following the planned Britannia merger, the merged business is expected to be strongly capitalised, taking into account the injection of an additional £120m as set out on page 28 and a further £55m which Co-operative Financial Services Limited intends to inject following the merger.

Consequently, after making enquiries, the Directors are satisfied that the Group has sufficient resources to continue in business for the foreseeable future and have therefore continued to adopt the going concern basis in preparing the financial statements.

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 10 January 2009.

In preparing these consolidated financial statements, the Bank has adopted Amendments to IAS 39 *Financial Instruments: Recognition and Measurement* and IFRS 7 *Financial Instruments: Disclosures – Reclassification of Financial Assets*. The amendments to IAS 39 and IFRS 7 impacted the reported profits and financial position of the Group and type and amount of disclosures made in these financial statements.

The Bank has not early adopted further amendments to IFRS 7 *Improving Disclosures about Financial Instruments* in line with the Co-operative Group accounting policy, however the Bank recognises the importance of providing relevant and useful information and has provided additional information in line with disclosures within the standard as follows:

- Fair value disclosures for each class of financial instrument by valuation method (refer to pages 77 and 78).
- Reconciliation of movements in fair value of instruments with significant unobservable inputs (refer to page 79).
- Liquidity risk disclosures on a behavioural basis for both derivative and non-derivative financial instruments (refer to pages 68 to 74).

Use of estimates and judgements

The preparation of financial statements requires management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised and in any future periods affected.

Information about significant areas of estimation uncertainty and critical judgements in applying accounting policies that have the most significant effect on the amounts recognised in the consolidated financial statements are described within the risk management section on pages 57 to 83 and the critical judgements section on pages 85 and 86.

Standards and interpretations issued but not yet effective

The Group has not adopted the following standards:

- IFRS 8 *Operating Segments*

  This standard introduces the 'management approach' to segment reporting. IFRS 8 will require disclosure of segment information based on the internal reports regularly reviewed by the Group's Chief Operating Decision Maker in order to assess each segment's performance and to allocate resources to them.

The amendments are effective for accounting periods beginning on or after 1 January 2009.

- Amendments to IAS 1 *Presentation of Financial Statements*

  This standard proposes a revised presentation to the income statement and revised changes to the naming of some primary statements. The amendments introduce a comprehensive statement of income that will present non-owner changes in equity in either a single statement of comprehensive income or a separate statement of income and other comprehensive income, initiated with the profit for the period.

  The amendments are effective for accounting periods beginning on or after 1 January 2009.

- Further amendments to IFRS 7 *Improving Disclosures about Financial Instruments*

  This standard enhances current financial instruments disclosures both for fair value measurement and liquidity risk. The amendments introduce increasing disclosure requirements in relation to fair value measurement, particularly when markets are inactive and enhancements to the information provided in relation to the nature and extent of liquidity risk.

  The amendments are effective for accounting periods beginning on or after 1 January 2009.

  Although, the Group is not required to comply with the IFRS 7 amendments, the Group has adopted certain amendments to the disclosures reported in the financial statements, as referred above.

- Revised IFRS 3 *Business Combinations (2008)*

  This standard incorporates the following changes:

  – The definition of a business has been broadened, which may result in more acquisitions being treated as business combinations.
  – Contingent consideration will be measured at fair value, with subsequent changes in fair value recognised in profit or loss.
  – Transaction costs, other than share and debt issue costs, will be expensed as incurred.
  – Any pre-existing interest in an acquiree will be measured at fair value, with the related gain or loss recognised in profit or loss.
  – Any non-controlling (minority) interest will be measured at either fair value, or at its proportionate interest in the identifiable assets and liabilities of an acquiree, on a transaction-by-transaction basis.

  Revised IFRS 3 is effective prospectively for annual accounting periods beginning on or after 1 July 2010.

- Amended IAS 27 *Consolidated and Separate Financial Statements (2008)*

  This standard requires accounting for changes in ownership interests in a subsidiary that occur without loss of control, to be recognised as an equity transaction. When the Bank loses control of a subsidiary, any interest retained in the former subsidiary will be measured at fair value with the gain or loss recognised in profit or loss.

  The amendment is effective for accounting periods beginning on 1 July 2009.

- IFRIC 13 *Customer Loyalty Programmes*

  This interpretation addresses the accounting by entities that operate or otherwise participate in customer loyalty programmes under which the customer can redeem credits for awards such as free or discounted goods or services.

  IFRIC 13 is effective for accounting periods beginning on or after 1 July 2008.

  The Bank is not expecting the above standards and amendments to existing standards to have a material impact on the information reported in the financial statements. The Bank is currently in the process of evaluating the potential effect of the IFRIC 13 interpretation.

  The following standards and interpretations which have been issued but not yet effective are not considered relevant to the Banks operations:

  – Amendment to IFRS 2 *Share-based Payment – Vesting Conditions and Cancellations*
  – Revised IAS 23 *Borrowing Costs*
  – Amendments to IAS 32 *Financial Instruments Presentation* and IAS 1 *Presentation of Financial Statements – Puttable Financial Instruments and Obligations Arising on Liquidation*
  – IFRIC 15 *Agreements for the Construction of Real Estate*
  – IFRIC 16 *Hedges of a Net Investment in a Foreign Operation*
  – IFRIC 17 *Distributions of Non-cash Assets to Owners*
  – IFRIC 18 *Transfer of Assets from Customers*

Change in accounting policy
In October 2008, the IASB issued Reclassification of Financial Assets (Amendments to IAS39 *Financial Instruments: Recognition and Measurement* and IFRS7 *Financial Instruments: Disclosures*). The amendment to IAS 39 permits an entity to transfer from the available for sale category to the loans and receivables category a non-derivative financial asset that would otherwise have met the definition of loans and receivables if the entity has the intention and ability to hold that financial asset for the foreseeable future or until maturity.

The amendment to IFRS 7 introduces additional disclosures if any entity has reclassified financial assets in accordance with the above amendment to IAS 39.

The amendments are effective retrospectively from 1 July 2008.

The Bank reclassified certain non-derivative financial assets in accordance with the amendment out of financial assets designated as available for sale into loans and receivables at amortised cost. The details of the impacts of the reclassification are disclosed in note 14.

Accounting date
The financial statements of the Bank and the Group relate to the 52 weeks to 10 January 2009. Since the Bank and Group accounting date is virtually coterminous with the calendar year 2008, figures in respect of the financial year are headed 2008 and the corresponding amounts for the 52 weeks to 12 January 2008 are headed 2007.

Significant accounting policies
The accounting policies set out below have been applied consistently to all periods presented in these financial statements.

(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 including arrangement and broker fees, valuation and solicitor costs 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 as the service is provided.

Fees and commissions payable to introducers in respect of obtaining lending business, where these are direct and incremental costs related to the issue of a financial instrument, are included in interest income as part of the effective interest rate.

(b) Significant items
Items which are material by both size and nature (i.e. outside of the normal operating activities of the Bank) are treated as significant items and disclosed separately on the face of the income statement.

The separate reporting of significant items helps provide an indication of the Bank's underlying business performance. Events which may give rise to the classification of items as significant include individually significant restructuring costs.

(c) Financial instruments (excluding derivatives)
Recognition
The Group initially recognises loans and advances, deposits, debt securities issued and other borrowed funds on the date at which they are originated. Regular way purchases and sales of financial assets are recognised on the trade date at which the Group commits to purchase or sell the asset. All other financial assets and liabilities are initially recognised on the trade date at which the Group becomes a party to the contractual provisions of the instrument.

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

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

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.

i) Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market and the Group does not intend to sell immediately or in the near term. These are initially measured at fair value plus transaction costs that are directly attributable to the financial asset. Subsequently, these are measured at amortised cost using the effective interest method. The amortised cost is the amount advanced less principal repayments, plus or minus the cumulative amortisation using the effective interest method of any difference between the amount advanced and the maturity amount less impairment provisions for incurred losses.

Loans and receivables mainly comprise loans and advances to banks and customers (except where the Group has elected to carry the loans and advances to customers at fair value through profit or loss as described in accounting policy (c) iii) below).

ii) 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 carrying value, which for equity securities is the difference between cost and fair value and for debt securities is the difference between amortised cost and fair value, recorded in equity as it occurs. Changes in value from foreign exchange gains and loss on non monetary items including equity securities are also recorded in equity. Changes in value from impairment and foreign exchange gains and losses on monetary items are recognised in the income statement. On disposal, gains and losses recognised previously in equity are transferred to the income statement.

iii) 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;
- 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

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

Objective evidence that financial assets are impaired can include default or delinquency by a borrower, restructuring of a loan or advance on terms that the Group would not otherwise consider, indications that a borrower or issuer will enter bankruptcy, the disappearance of an active market for a security.

The Group considers evidence for impairment for loans and advances at both a specific asset and collective level. All individually significant loans and advances are assessed specifically for impairment. Loans and advances not individually significant are collectively assessed for impairment by grouping together loans and advances by similar risk characteristics.

In assessing collective impairment the Group uses statistical modelling of historical trends of probability of default, timing of recoveries and the amount of loss incurred, adjusted for management's judgement as to whether current economic and credit conditions are such that actual losses are likely to be greater or less than suggested by historical modelling. Default rates, loss rates and the expected timing of future recoveries are regularly benchmarked against actual outcomes to ensure that they remain appropriate.

The amount of the loss is the difference between:

- the asset's carrying amount; and
- the present value of estimated future cash flows (discounted at the asset's original or variable effective interest rate for amortised cost assets and at the current market rate for available for sale assets).

Impairment of financial assets carried at amortised cost

The amount of the impairment loss on assets carried at amortised cost is recognised immediately through the income statement and a corresponding reduction in the value of the financial asset is recognised through the use of an allowance account.

The written down value of the impaired financial asset 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 uncollectable or forgiven. Write-offs are charged against previously established provisions for impairment or directly to the income statement.

Provisions are released at the point when it is deemed that the risk of loss has reduced to the extent that a provision is no longer required.

Impairment of financial assets classified as available for sale

Impairment losses on available for sale assets are recognised by transferring the difference between the acquisition cost (net of any principle repayments and amortisation) and current fair value out of equity to profit or loss.

When a subsequent event causes the amount of impaired loss on available for sale debt securities to decrease and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed through profit or loss. However any subsequent recovery in fair value of an impaired available for sale equity security is recognised directly in equity.

(d) 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.

(e) 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 based on quoted market prices in active markets, and where these are not available, using valuation techniques such as discounted cash flow models. Further information is provided on page 79. 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.

On initial designation of derivatives and qualifying hedging instrument as a hedge, the Bank formally documents the relationship between the hedging instrument(s) and hedged item(s) including the risk management objective and strategy in undertaking the hedge transaction together with the method used to assess effectiveness of hedging relationship.

The Bank makes an assessment, both at the inception of the hedge relationship as well as on an ongoing basis, whether the hedging instruments are expected to be ‘highly effective’ on offsetting the changes in fair value or cash flows of the respective hedged items during the period for which the hedge is designated, and whether the actual results of each hedge are within a range of 80–125 percent.

Embedded derivatives:

A derivative may be embedded in another instrument, known as the host contract. Where the economic characteristics and risks of an embedded derivative are not closely related to those of the host contract, 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 relevant accounting policy for that particular asset or liability.

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 fails or is dedesignated 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.

Where the forecast transaction is no longer expected to occur, the cumulative gain or loss remaining in equity is recognised in the income statement.

Fair value hedges:

Where a derivative is designated as the hedging instrument in a hedge of the change in fair value of a recognised asset or liability or a firm commitment that could affect profit or loss, changes in the value of the derivative are recognised immediately in profit or loss together with changes in the fair value of the hedged item that are attributable to the hedged risk.

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

If the derivative expires or is sold, terminated, or exercised, or no longer meets the criteria for fair value hedge accounting, or the designation is revoked, then hedge accounting is prospectively discontinued. Any adjustment up to that point, to a hedged item for which the effective interest method is used, is amortised to profit or loss as part of the recalculated effective interest rate of the item over its remaining life.

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.

(f) Property, plant and equipment
Items of property, plant and equipment are stated at cost less any accumulated depreciation and impairment losses. Depreciation is provided on a straight line basis at the following rates, which are estimated to write down the assets to realisable values at the end of their useful lives.

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

All items of property, plant and equipment are regularly reviewed for indications of impairment. Any impairment identified would be charged to the income statement.

(g) Intangible assets – Computer software
All costs directly attributable 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.

(h) Assets leased to customers
Finance leases:
Leases in terms of which the Bank assumes substantially all the risks and rewards of ownership are classified as finance leases and are included within 'loans and advances to customers'. Finance leases are 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.

(i) Cash and cash equivalents
Cash and cash equivalents comprises cash balances and balances with a maturity of three months or less from the acquisition date, which are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value.

(j) Income tax
Tax on the profit or loss for the year comprises current and deferred tax, which is recognised in the income statement except to the extent that it relates to items recognised directly in equity, in which case it is recognised in equity.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at the balance sheet date, and any adjustment to tax payable in respect of previous years.

Deferred tax is provided using the balance sheet method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. The amount of deferred tax provided for is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantively enacted at the balance sheet date.

A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the asset can be utilised.

Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

(k) Pension costs
Defined contribution basis
With effect from 6 April 2006, the Bank Group, along with other businesses within the Co-operative Group, has participated in the Co-operative Group Pension (Average Career Earnings) Scheme (the PACE scheme). This scheme is a defined benefit scheme, the assets of which are held in a separate fund administered by trustees. As a group-wide pension scheme, the PACE scheme exposes the participating businesses to actuarial risks associated with the current and former employees of other group companies, with the result that there is no consistent and reliable basis for allocating liabilities, assets and costs to individual companies participating in the scheme. Therefore pension costs in respect of the scheme are accounted for on a defined contribution basis and recognised as an expense in the income statement as incurred.

(l) Foreign currency

The functional and presentational currency for the Bank is sterling. Transactions in foreign currencies are translated at the foreign exchange rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are translated to sterling at the foreign exchange rate ruling at that date except for foreign currency differences arising on retranslation of available for sale equity instruments or a qualifying cashflow hedge, which are recognised directly in equity. Foreign exchange differences arising on translation are recognised in the income statement. Non-monetary assets and liabilities denominated in foreign currencies that are stated at fair values are translated to sterling at the exchange rates ruling at the dates the values were determined.

(m) 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 classifies capital instruments as financial liabilities or equity instruments in accordance with the substance of the contractual terms of the instruments. The Bank's preference shares are classified as financial liabilities as they carry the right to a fixed non-cumulative preferential dividend (further information is provided in note 23) and are subsequently 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.

(n) Financial guarantees

All financial guarantees in respect of intra-group funding between the Bank and its subsidiaries are treated as insurance contracts in accordance with IFRS 4.

(o) Investments in group undertakings

Investments in subsidiaries are initially measured at fair value which equates to cost and subsequently valued at cost less impairment.

(p) Basis of Consolidation

Subsidiaries

Subsidiaries are entities controlled by the Bank. Control exists when the Bank has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. In assessing control, potential voting rights that presently are exercisable are taken into account. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases. The financial statements have been prepared using uniform accounting policies and are based on the same accounting period as the Bank except for Unity Trust Bank PLC and The Covered Bond LLP which are drawn up to the entity accounting reference date of 31 December. Significant transactions recognised between the subsidiaries accounting reference date and the consolidated accounting date are adjusted in the consolidated financial statements.

Intra-group balances and transactions, and any unrealised gains and losses arising from Intra-group transactions, are eliminated in preparing the consolidated statements.

Special purpose entities

Special purpose entities (SPEs) are entities that are created to accomplish a narrow and well-defined objective, for the Bank this includes the creation of The Covered Bond LLP in order to act as a guarantor for the issue of covered bonds during 2008. (refer to note 32 for further information). An SPE is consolidated if, based on an evaluation of the substance of its relationship with the Bank and the SPE's risks and rewards, the Bank concludes that it controls the SPE. The following circumstances may indicate a relationship in which, in substance, the Bank controls and consequently consolidates and SPE:

- The activities of the SPE are being conducted on behalf of the Bank according to its specific business needs so that the Bank obtains benefits from the SPE's operation.
- The Bank has the decision making powers to obtain the majority of the benefits of the activities of the SPE.
- The Bank has the rights to obtain the majority of the benefits of the SPE and therefore may be exposed to the risks incidental to the activities of the SPE.
- The Bank retains the majority of the residual or ownership risks related to the SPE or its assets in order to obtain benefits from its activities.

The assessment of whether the Bank has control over an SPE is carried out at inception and normally no further assessment of control is carried out in the absence of changes in the structure or terms of the SPE, or additional transactions between the Bank and the SPE.

(q) Provisions

A provision is recognised in the balance sheet if the Bank has a legal or constructive obligation as a result of a past event and it is probable that an outflow of economic benefits will be required to settle the obligation. If the effect is material, provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability.

(r) Profit based payments to members of the Co-operative Group

Members of the Co-operative Group receive a dividend based on their transactions with the Group and its subsidiaries including the Bank.

These payments represent a recharge of the proportion of the dividend payable where the underlying transaction is a Bank product. The recharge is recognised on an accruals basis calculated as the amount due to members for relevant transactions in the financial year.

The CFS group of companies including Co-operative Financial Services Limited, Co-operative Insurance Society Limited (Life & Savings business), CIS General Insurance Limited, and The Co-operative Bank p.l.c. have a common Board composition.

CFS has developed and implemented a common governance and organisation structure, with the same committee structure supporting each Board within the CFS Group.

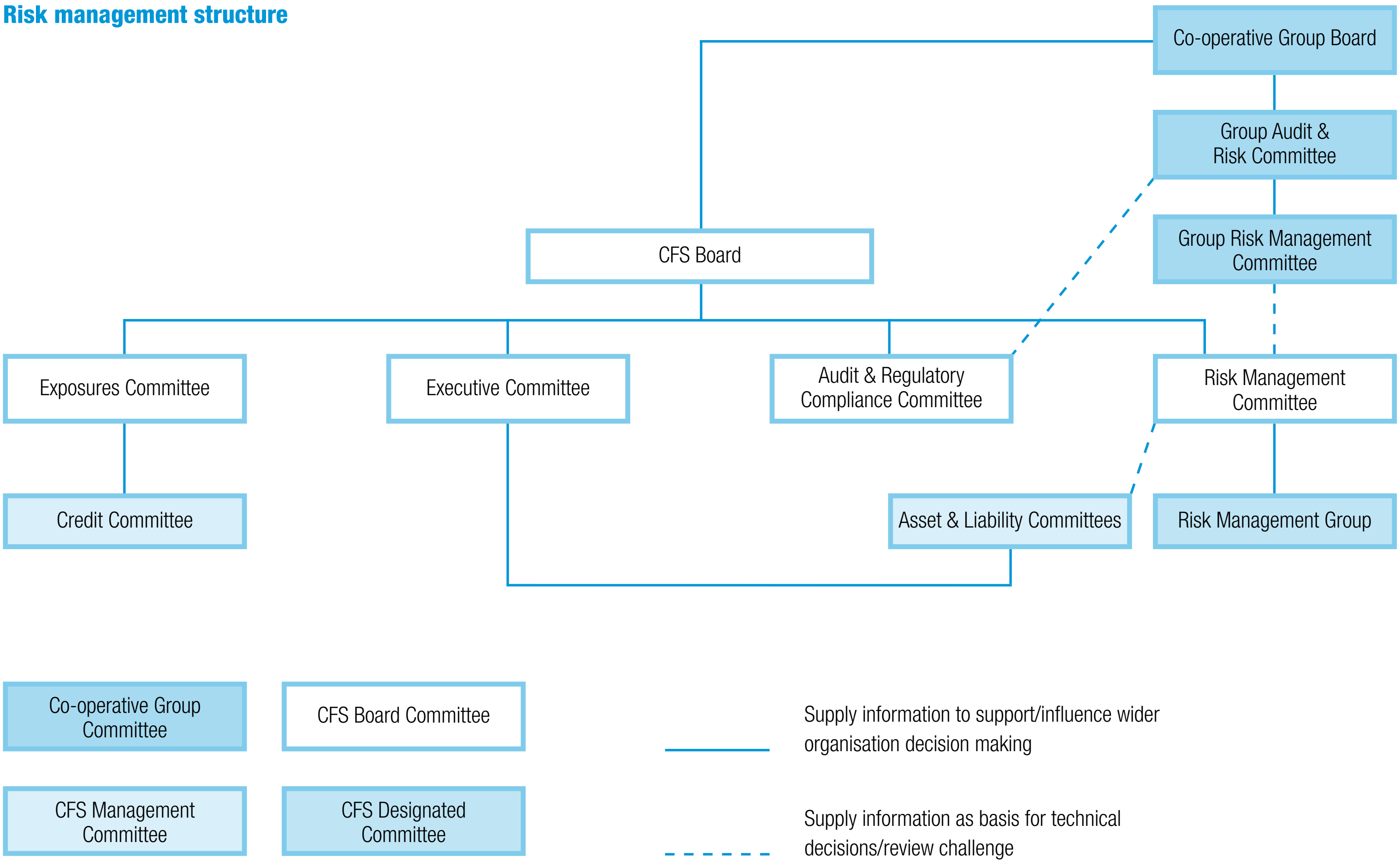
The CFS Board has ultimate responsibility for the management of all risks across CFS.

The Board is responsible for approving the CFS strategy, its principal markets and the level of acceptable risks articulated through its statement of risk appetite. It is also responsible for overall corporate governance, which includes ensuring that there is an adequate system of risk management and that the level of capital held is consistent with the risk profile of the business.

The Board has established Board Committees and Senior Management Committees to administer, oversee and challenge the risk management process, identifying the key risks facing the business and assessing the effectiveness of planned management actions.

Specific Board 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



The CFS Board delegates authority to the CFS Risk Management Committee (RMC) (Senior Board Committee) for monitoring compliance with the Board-approved risk appetite statements. This includes:

- setting limits for individual types of risk; and
- approving (at least annually) and monitoring compliance with risk policies and delegated levels of authority.

CFS Risk Management Committee (RMC): this committee is responsible for review and challenge of the adequacy of capital for all risks (including operational risk), and for technical risk management activities and portfolio exposures across CFS including:

- operation of mandates and limits;
- technical risk management policy approval;
- risk management information reporting and integrity of relevant data;
- risks adequately identified and measured;
- risk and portfolio exposure management strategy;
- adequacy of the risk mitigation process; and
- review and discussion of technical risk issues identified as a result of internal audit work.

CFS Audit & Regulatory Compliance Committee (ARCC): this committee provides independent oversight in relation to financial reporting; internal control and risk management regulatory compliance; and external and internal audit. It is responsible for approval of policies and review of adequacy of risk management activities in relation to operational risk.

CFS Exposures Committee: this committee ensures that Non-Executive Directors are actively involved in major credit decisions (including sanctioning large counterparty transactions), monitor large exposures and problem loans and review the adequacy of individual credit provisions.

CFS Executive Committee: this committee manages the business in line with the Board Risk Appetite Statement. It also maintains oversight of risk management processes and management information.

CFS Asset & Liability Committees (ALCO): these committees are management committees of the Board which are chaired by the Chief Executive. They are primarily responsible for overseeing the management of interest rate, market, liquidity and funding risks and to advise on capital utilisation, in addition to, the composition and sourcing of adequate capital.

CFS Risk Management Group (RMG): this committee is a designated committees reporting to RMC and chaired by the Chief Financial Officer. Its purpose is to provide a mechanism to ensure that CFS-wide technical risk management requirements, developments and processes are approved (with escalation to RMC where required) and embedded within and across CFS. The Committee also monitors all significant and emerging risks, and oversees the development and implementation of stress testing and risk appetite across CFS.

CFS Credit Committee: this committee is chaired by the Director of Banking Risk and Capital Management. The Chair has delegated authority for approving credit facilities within approved strategies and delegated authorities.

CFS Operational Risk Committee: this committee interfaces with both the Executive Committee and ARCC and is chaired by the Head of Operational Risk. It monitors significant operational risks and controls as well as the management actions taken to mitigate them to an acceptable level and/or transfer them. This includes business continuity arrangements and insurance cover to protect the CFS business. Each division within CFS is represented on the committee. The committee is not shown on the previous diagram as it is an information sharing committee, designed to increase understanding and transparency of significant operational risks and reporting is via the Operational Risk department.

There is also a framework of sector specific management committees supporting risk and capital management, and implementing changes in business strategy, optimising performance, adherence to and setting of policy, and development of management information and training.

Bank significant risks

The Bank's significant risks arise in four broad categories:

- credit risk;
- market risk;
- liquidity risk; and
- operational risk.

Credit risk

Credit risk is the current or prospective risk to earnings and capital arising from an obligor's failure to meet the terms of any contract with the Bank or its failure to perform as agreed.

Credit risk is an integral part of many of our business activities and is inherent in traditional banking products (loans, commitments to lend and contingent liabilities, such as letters of credit) and in 'traded products' (derivative contracts such as forwards, swaps and options, repurchase agreements, and securities borrowing and lending transactions).

All amounts are stated in £m unless otherwise indicated

The Credit Risk Management Policies are approved by the RMC annually and are the responsibility of the Director of Banking Risk and Capital Management. The policies determine the criteria for the management of retail, corporate and wholesale market exposures and credit management standards, including country, sector and counterparty limits, along with delegated authorities. Larger corporate facilities are sanctioned by the Board's Exposures Committee who also review, each month, facilities granted within the Chief Executive's discretion.

All authority to take credit risk derives from the CFS Board. This is delegated through authorities to individuals via the Chief Executive. The level of credit risk authority delegated to holders depend upon seniority and experience, varying according to the quality of the counterparty or any associated security or collateral held.

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. The quality of the portfolio and individual customers is monitored using risk rating systems and scorecards calibrated to risk of default and expected loss, and the Board receives an update on bad debt biannually. The Risk Management Committee receives regular reports on the performance of the portfolio.

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 expected loss. All aspects of credit management are controlled centrally. The Risk Management Committee receives regular reports on the performance of the portfolio. The Exposures Committee receives regular reports on new facilities and changes in facilities, sector exposures, bad debt provisions and the realisation of problem loans.

The Bank's Wholesale markets credit risk framework takes an holistic approach to risk management with, at its centre, a credit risk policy which governs the types of exposure the business can take and sets concentration parameters. To complement this, individual authority is delegated in terms of Internal Rating Grade (IRG) and associated Probability of Default (PD) to approve limits to individual counter parties within the parameters established by the credit risk policy. The Risk Management Committee receives regular reports on the performance of the portfolio. The Exposures Committee receives regular reports on changes in exposure limits, watchlist and problem counterparty information.

Credit exposure

Group	Notes	**Gross balance 2008**	**Credit commitments 2008**	**Credit risk exposure 2008**	Gross balance 2007	Credit commitments 2007	Credit risk exposure 2007
Loans and advances to banks	12	**1,886.7**	**201.3**	**2,088.0**	1,204.0	226.3	1,430.3
Loans and advances to customers	13	**10,494.2**	**5,397.4**	**15,891.6**	9,169.7	6,236.3	15,406.0
Debt securities	14	**2,324.0**	**–**	**2,324.0**	2,462.7	–	2,462.7
Derivative financial instruments	15	**203.0**	**–**	**203.0**	88.2	–	88.2
		14,907.9	**5,598.7**	**20,506.6**	12,924.6	6,462.6	19,387.2
Allowance for impairment losses on loans and advances	13			**(187.9)**			(160.7)
Impairment losses on investments	14			**(92.3)**			(31.8)
Total carrying amount				**20,226.4**			19,194.7

Bank	Notes	**Gross balance 2008**	**Credit commitments 2008**	**Credit risk exposure 2008**	Gross balance 2007	Credit commitments 2007	Credit risk exposure 2007
Loans and advances to banks	12	**1,897.5**	**201.3**	**2,098.8**	1,211.2	226.3	1,437.5
Loans and advances to customers	13	**11,356.8**	**5,386.9**	**16,743.7**	9,075.1	6,225.7	15,300.8
Debt securities	14	**1,902.5**	**–**	**1,902.5**	2,017.5	–	2,017.5
Derivative financial instruments	15	**233.4**	**–**	**233.4**	88.5	–	88.5
		15,390.2	**5,588.2**	**20,978.4**	12,392.3	6,452.0	18,844.3
Allowance for impairment losses on loans and advances	13			**(187.0)**			(160.7)
Impairment losses on investments	14			**(92.3)**			(31.8)
Total carrying amount				**20,699.1**			18,651.8

Credit commitments include revocable commitments which are unused credit card limits of £3,034.1m (2007: £3,624.2m).

Notes 13 and 14 provide further analysis on concentration of credit risk.

All amounts are stated in £m unless otherwise indicated

Credit risk analysis:

2008 **Group**	**Loans and advances to banks**	**Loans and advances to customers**	**Debt securities**	**Derivative financial instruments**	**Total**
Individually impaired					
90 days past due or evidence of impairment	**–**	**140.6**	**97.5**	**–**	**238.1**
Impairment recognised	**–**	**(47.1)**	**(82.3)**	**–**	**(129.4)**
Carrying amount	**–**	**93.5**	**15.2**	**–**	**108.7**
Collectively impaired					
Less than 90 days past due	**–**	**66.4**	**97.2**	**–**	**163.6**
90-179 days past due	**–**	**27.6**	**–**	**–**	**27.6**
180 days plus past due	**–**	**127.1**	**–**	**–**	**127.1**
Impairment recognised	**–**	**(140.8)**	**(10.0)**	**–**	**(150.8)**
Carrying amount	**–**	**80.3**	**87.2**	**–**	**167.5**
Past due but not impaired					
0-29 days past due	**–**	**11.5**	**–**	**–**	**11.5**
30-59 days past due	**–**	**2.2**	**–**	**–**	**2.2**
60-89 days past due	**–**	**1.3**	**–**	**–**	**1.3**
Carrying amount	**–**	**15.0**	**–**	**–**	**15.0**
Neither past due or impaired					
Low to medium risk	**2,088.0**	**13,138.5**	**2,129.3**	**203.0**	**17,558.8**
Medium to high risk	**–**	**2,376.4**	**–**	**–**	**2,376.4**
Carrying amount	**2,088.0**	**15,514.9**	**2,129.3**	**203.0**	**19,935.2**
Total carrying amount	**2,088.0**	**15,703.7**	**2,231.7**	**203.0**	**20,226.4**

2007 **Group**	Loans and advances to banks	Loans and advances to customers	Debt securities	Derivative financial instruments	Total
Individually impaired					
90 days past due or evidence of impairment	–	94.6	63.2	–	157.8
Impairment recognised	–	(35.6)	(31.8)	–	(67.4)
Carrying amount	–	59.0	31.4	–	90.4
Collectively impaired					
Less than 90 days past due	–	75.9	–	–	75.9
90-179 days past due	–	29.3	–	–	29.3
180 days plus past due	–	102.9	–	–	102.9
Impairment recognised	–	(125.1)	–	–	(125.1)
Carrying amount	–	83.0	–	–	83.0
Past due but not impaired					
0-29 days past due	–	7.3	–	–	7.3
30-59 days past due	–	2.1	–	–	2.1
60-89 days past due	–	1.5	–	–	1.5
Carrying amount	–	10.9	–	–	10.9
Neither past due or impaired					
Low to medium risk	1,430.3	13,002.8	2,399.5	88.2	16,920.8
Medium to high risk	–	2,089.6	–	–	2,089.6
Carrying amount	1,430.3	15,092.4	2,399.5	88.2	19,010.4
Total carrying amount	1,430.3	15,245.3	2,430.9	88.2	19,194.7

All amounts are stated in £m unless otherwise indicated

2008 Bank	**Loans and advances to banks**	**Loans and advances to customers**	**Debt securities**	**Derivative financial instruments**	**Total**
Individually impaired					
90 days past due or evidence of impairment	**–**	**133.8**	**97.5**	**–**	**231.3**
Impairment recognised	**–**	**(46.2)**	**(82.3)**	**–**	**(128.5)**
Carrying amount	**–**	**87.6**	**15.2**	**–**	**102.8**
Collectively impaired					
Less than 90 days past due	**–**	**66.4**	**97.2**	**–**	**163.6**
90-179 days past due	**–**	**27.6**	**–**	**–**	**27.6**
180 days plus past due	**–**	**127.2**	**–**	**–**	**127.2**
Impairment recognised	**–**	**(140.8)**	**(10.0)**	**–**	**(150.8)**
Carrying amount	**–**	**80.4**	**87.2**	**–**	**167.6**
Past due but not impaired					
0-29 days past due	**–**	**11.5**	**–**	**–**	**11.5**
30-59 days past due	**–**	**2.2**	**–**	**–**	**2.2**
60-89 days past due	**–**	**1.3**	**–**	**–**	**1.3**
Carrying amount	**–**	**15.0**	**–**	**–**	**15.0**
Neither past due or impaired					
Low to medium risk	**2,098.8**	**13,997.3**	**1,707.8**	**233.4**	**18,037.3**
Medium to high risk	**–**	**2,376.4**	**–**	**–**	**2,376.4**
Carrying amount	**2,098.8**	**16,373.7**	**1,707.8**	**233.4**	**20,413.7**
Total carrying amount	**2,098.8**	**16,556.7**	**1,810.2**	**233.4**	**20,699.1**

2007 Group	Loans and advances to banks	Loans and advances to customers	Debt securities	Derivative financial instruments	Total
Individually impaired					
90 days past due or evidence of impairment	–	94.6	63.2	–	157.8
Impairment recognised	–	(35.6)	(31.8)	–	(67.4)
Carrying amount	–	59.0	31.4	–	90.4
Collectively impaired					
Less than 90 days past due	–	75.9	–	–	75.9
90-179 days past due	–	29.3	–	–	29.3
180 days plus past due	–	102.9	–	–	102.9
Impairment recognised	–	(125.1)	–	–	(125.1)
Carrying amount	–	83.0	–	–	83.0
Past due but not impaired					
0-29 days past due	–	7.3	–	–	7.3
30-59 days past due	–	2.1	–	–	2.1
60-89 days past due	–	1.5	–	–	1.5
Carrying amount	–	10.9	–	–	10.9
Neither past due or impaired					
Low to medium risk	1,437.5	12,901.1	1,954.3	88.5	16,381.4
Medium to high risk	–	2,086.1	–	–	2,086.1
Carrying amount	1,437.5	14,987.2	1,954.3	88.5	18,467.5
Total carrying amount	1,437.5	15,140.1	1,985.7	88.5	18,651.8

Analysis of Impaired Assets and Associated Collateral

Impaired Assets

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

The loan portfolios are reviewed on a continuous basis to assess impairment. In determining whether a bad debt provision should be recorded, judgments 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.

Corporate loans and retail mortgage lending with evidence of impairment including 90 days past due are individually assessed for impairment. Collectively impaired assets include unsecured retail lending balances. Provisions are applied to credit card balances at 30 days past due and at 45 days past due on all other unsecured retail lending balances.

At the balance sheet date, the Bank assesses its debt securities for objective evidence that an impairment loss has occurred. For a debt security this may be the disappearance of an active market. For available for sale debt securities particular consideration is given to evidence of any significant financial difficulty of the issuer or measurable decrease in the estimated cash flows from the investments.

Past due but not impaired

Loans and securities are considered past due where the contractual interest or principal payment are in arrears, but the Bank believes that impairment is not appropriate as a trigger point for impairment has not been reached, this could be the stage of collection of amounts owed to the Bank.

In the table past due but not impaired represents mortgage and unsecured retail lending balances past due but not considered impaired. This includes credit card exposures less than 30 days and 45 days for other retail unsecured lending.

Within the credit risk analysis table, low to medium risk has been defined as exposures where probability of default (PD) is 1% or below over a 1 year time horizon for exposures on IRB Approach under Basel II and slotting category strong/good/satisfactory for specialised lending exposures under the slotting approach. Medium to high risk has been defined as a probability of default of greater than 1% over a 1 year time horizon for exposure on IRB Approach under Basel II and slotting category weak for specialised lending exposures under the slotting approach.

Loans with renegotiated terms are loans that have been renegotiated due to the deterioration in the borrower's financial position but where the Group have agreed concessions that it would not otherwise consider. These renegotiated loans are considered as continuing to be impaired, and as such these are disclosed as impaired.

Within the Treasury debt security portfolio over 77% of exposures have an external credit rating equivalent to Fitch A or above. The Bank has no direct exposure to Asset Backed Securities (ABS). It is only indirectly exposed within the portfolios held by the £2.7m (net of provision) (2007: £31.4m) holding of Structured Investments.

The factors considered in determining if financial assets are individually impaired are stated above and within critical judgements on pages 85 and 86.

Description of collateral

The Bank uses collateral and guarantees to mitigate credit risk. Collateral is regularly revalued and guarantees reviewed to ensure continuing effectiveness. The majority of collateral held is not eligible financial collateral, but is real estate collateral either as retail mortgages or real estate collateral held against Corporate lending.

When calculating the value of collateral for regulatory capital risk mitigation purposes, the appropriate valuation criteria contained within BIPRU is applied. Robust policies are in place to manage collateral and valuation.

Where exposures are agreed on a secured basis, security cover is taken into account only where:

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

Eligible financial collateral includes gilts held as part of reverse repo agreements, and cash as part of collateralised swaps or against corporate lending. The guarantees include parental guarantees held against subsidiary exposures.

At the reporting date, the fair value of collateral as security against financial assets that are past due but not impaired was £20.5m (2007: £21.9m).
At the reporting date, the fair value of collateral as security against individually impaired financial assets was £61.3m (2007: £44.3m).
At the reporting date, the carrying value of assets obtained by taking possession of collateral or by calling on guarantees was £1.4m (2007: £2.0m).

All amounts are stated in £m unless otherwise indicated

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 CFS Risk Management 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. ALCO meets monthly and its prime task is to assess the interest rate risk inherent in the maturity and repricing characteristics of the Bank's assets and liabilities. It sets limits within which Treasury and CFS' Corporate Finance department manage the effect of interest rate changes on the Bank's overall net interest income. Treasury are responsible for interest rate risk management for Treasury and CFS' Corporate Finance department manage interest rate risk within the rest of the Bank. The principal analytical techniques involve assessing the impact of different interest rate scenarios and changes in balances over various time periods.

The Board receives 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.

Non-Treasury interest rate risk

The Bank (excluding Treasury) uses an earnings approach to managing interest rate risk, focusing in detail on the sensitivity of assumed changes in interest rates on net interest income for one year. Higher level analysis is performed for subsequent years. The Bank does not consider economic value an appropriate measure for interest rate risk in the non-trading book (excluding Treasury).

ALCO, the Board sub-committee responsible for monitoring compliance with interest rate risk limits, meets on a monthly basis. ALCO monitors the non-trading interest rate risk which is split between certain Treasury portfolios, banking and investment books, and the rest of the Bank. The Bank non-trading portfolios excluding these certain Treasury portfolios, are managed by Corporate Finance. All interest rate risk is centralised into Corporate Finance using appropriate transfer pricing rates.

The management of interest rate risk is supplemented by the use of gap reports, which are based on defined time periods. ALCO set guidance limits around the gap, principally that the sum of positions maturing in greater than twelve months and non-sensitive balances (includes non-maturity deposits) is no more than £350m.

Risk limits are formally calculated at each month-end. Interest rate risk and effectiveness of hedging is monitored daily using gap positions, incorporating new business requirements. Draw down risk, in particular for fixed rate mortgages, is managed through weekly balance sheet meetings. Corporate Finance undertake hedges for interest rate risk using derivative instruments and investment securities which are executed via Treasury to wholesale markets, and loans and deposits which are executed internally with Treasury.

The table below illustrates the sensitivity analysis relating to Bank's non-trading book (excluding Treasury) prepared by Corporate Finance, a primary measure in the approach to managing interest rate risk.

The Bank's balances excluding Treasury are wholly GBP sterling and the table illustrates the estimated change in net income over the next 12 month period based on a 1% shock in interest rates across the yield curve. The percentage change in forecast net interest income (NII) as a proportion of cumulative net interest income for the next 12 months is shown below. The shock results are driven by product pricing and product mix. The extent of rate movements and low rate environment have impacted the repricing of liability products resulting in larger exposure to rate shocks.

Percentage change in net interest income over next 12 months based on 100bp shock in interest rates

2008	**100bp parallel increase**	**100bp parallel decrease**
At the year-end	**4.9%**	**(5.0%)**
Average for the period	**0.1%**	**(0.7%)**
Maximum for the period	**5.0%**	**(5.1%)**
Minimum for the period	**0.4%**	**0.2%**
2007		
At the year-end	(0.6%)	0.5%
Average for the period	(0.9%)	0.9%
Maximum for the period	(1.3%)	1.4%
Minimum for the period	(0.6%)	0.5%

All amounts are stated in £m unless otherwise indicated

Treasury interest rate risk

Treasury executes short term 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 a one day holding period. 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.

Trading value at risk:

At 10 January 2009, total Treasury VaR of £1.1m (2007: £0.5m) 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 year ended 10 January 2009 were £0.7m (2007: £0.7m), £1.5m (2007: £1.4m) and £0.2m (2007: £0.4m).

PV01 is used as an additional risk measure with respect to Treasury positions 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. A number of different scenarios including +/- 10bp, 100bp are also calculated. PV100 is provided below.

PV100

The table below illustrates the change in valuation on a fixed income portfolio experienced given a 1% increase and decrease in interest rates for Treasury, representing Treasury Banking Book and Trading Book combined. PV100 is the effect on the net present value (NPV) of the Treasury portfolio to a parallel shift of 100 basis points upon the base yield curve. PV100 is calculated daily, the average for the period is the average over 252 business days, maximum and minimum represents the high and low points during the year.

	1% increase in interest rates		**1% decrease in interest rates**	
	2008	2007	**2008**	2007
At reporting date	**(3.1)**	(4.4)	**3.1**	4.4
Average in the period	**(5.0)**	(11.8)	**5.8**	14.1
Maximum	**(9.9)**	(16.9)	**12.4**	21.4
Minimum	**(1.3)**	(4.4)	**1.3**	4.4

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 US dollars by raising funds and investing these to generate a return; and
- performing limited intra-day trading and overnight positioning in major currencies to generate incremental income.

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

	£	**$**	**€**	**Other**	**Total**	£	$	€	Other	Total
Group	**2008**	**2008**	**2008**	**2008**	**2008**	2007	2007	2007	2007	2007
Assets										
Cash and balances at central banks	**164.7**	**–**	**–**	**–**	**164.7**	171.1	–	1.8	–	172.9
Loans and advances to banks	**1,666.2**	**19.3**	**198.5**	**2.7**	**1,886.7**	1,154.9	37.3	9.7	2.1	1,204.0
Loans and advances to customers	**10,064.6**	**72.8**	**154.0**	**14.9**	**10,306.3**	8,685.9	159.6	152.1	11.4	9,009.0
Debt securities	**1,912.1**	**96.0**	**223.6**	**–**	**2,231.7**	2,052.2	173.2	205.5	–	2,430.9
Derivative financial instruments	**203.0**	**–**	**–**	**–**	**203.0**	88.2	–	–	–	88.2
Equity shares	**13.0**	**–**	**–**	**–**	**13.0**	8.8	–	–	–	8.8
Intangible fixed assets	**2.3**	**–**	**–**	**–**	**2.3**	5.2	–	–	–	5.2
Property, plant and equipment	**59.6**	**–**	**–**	**–**	**59.6**	79.8	–	–	–	79.8
Other assets	**27.4**	**0.7**	**2.8**	**0.3**	**31.2**	11.8	1.9	2.6	0.2	16.5
Prepayments & accrued income	**65.6**	**–**	**–**	**–**	**65.6**	71.6	–	–	–	71.6
Total assets	**14,178.5**	**188.8**	**578.9**	**17.9**	**14,964.1**	12,329.5	372.0	371.7	13.7	13,086.9

All amounts are stated in £m unless otherwise indicated

Group	£ 2008	$ 2008	€ 2008	Other 2008	Total 2008	£ 2007	$ 2007	€ 2007	Other 2007	Total 2007
Liabilities										
Deposits by banks	**557.4**	**93.9**	**419.3**	**1.7**	**1,072.3**	420.7	106.4	134.2	–	661.3
Customer accounts	**11,844.1**	**18.5**	**40.3**	**5.9**	**11,908.8**	10,504.5	24.4	27.8	2.8	10,559.5
Debt securities in issue	**530.0**	**7.2**	**30.8**	**–**	**568.0**	90.9	234.4	210.5	–	535.8
Derivative financial instruments	**97.2**	**7.8**	**12.9**	**–**	**117.9**	68.2	13.2	10.9	–	92.3
Other borrowed funds	**358.4**	**–**	**–**	**–**	**358.4**	358.1	–	–	–	358.1
Other liabilities	**91.4**	**0.1**	**0.2**	**–**	**91.7**	100.7	2.2	0.9	–	103.8
Accruals and deferred income	**22.3**	**–**	**–**	**–**	**22.3**	37.5	–	–	–	37.5
Provisions	**15.8**	**–**	**–**	**–**	**15.8**	9.4	–	–	–	9.4
Current tax liabilities	**1.2**	**–**	**–**	**–**	**1.2**	6.1	–	–	–	6.1
Deferred tax liabilities	**27.0**	**–**	**–**	**–**	**27.0**	6.2	–	–	–	6.2
Total liabilities	**13,544.8**	**127.5**	**503.5**	**7.6**	**14,183.4**	11,602.3	380.6	384.3	2.8	12,370.0
Net on-balance sheet position	**633.7**	**61.3**	**75.4**	**10.3**	**780.7**	727.2	(8.6)	(12.6)	10.9	716.9

Bank	£ 2008	$ 2008	€ 2008	Other 2008	Total 2008	£ 2007	$ 2007	€ 2007	Other 2007	Total 2007
Assets										
Cash and balances at central banks	**164.7**	**–**	**–**	**–**	**164.7**	171.1	–	1.8	–	172.9
Loans and advances to banks	**1,677.0**	**19.3**	**198.5**	**2.7**	**1,897.5**	1,162.1	37.3	9.7	2.1	1,211.2
Loans and advances to customers	**10,928.1**	**72.8**	**154.0**	**14.9**	**11,169.8**	8,591.3	159.6	152.1	11.4	8,914.4
Debt securities	**1,490.6**	**96.0**	**223.6**	**–**	**1,810.2**	1,607.0	173.2	205.5	–	1,985.7
Derivative financial instruments	**233.4**	**–**	**–**	**–**	**233.4**	88.5	–	–	–	88.5
Equity shares	**13.0**	**–**	**–**	**–**	**13.0**	8.8	–	–	–	8.8
Interests in group undertakings	**969.3**	**–**	**–**	**–**	**969.3**	2.7	–	–	–	2.7
Intangible fixed assets	**1.5**	**–**	**–**	**–**	**1.5**	4.3	–	–	–	4.3
Property, plant and equipment	**53.9**	**–**	**–**	**–**	**53.9**	74.0	–	–	–	74.0
Current tax asset	**2.5**	**–**	**–**	**–**	**2.5**	–	–	–	–	–
Other assets	**27.2**	**0.7**	**2.8**	**0.3**	**31.0**	11.7	1.9	2.6	0.2	16.4
Prepayments & accrued income	**56.8**	**–**	**–**	**–**	**56.8**	44.9	–	–	–	44.9
Total assets	**15,618.0**	**188.8**	**578.9**	**17.9**	**16,403.6**	11,766.4	372.0	371.7	13.7	12,523.8

	£ 2008	$ 2008	€ 2008	Other 2008	Total 2008	£ 2007	$ 2007	€ 2007	Other 2007	Total 2007
Liabilities										
Deposits by banks	**557.4**	**93.9**	**419.3**	**1.7**	**1,072.3**	420.7	106.4	134.2	–	661.3
Customer accounts	**13,324.0**	**18.5**	**40.3**	**5.9**	**13,388.7**	10,013.1	24.4	27.8	2.8	10,068.1
Debt securities in issue	**530.0**	**7.2**	**30.8**	**–**	**568.0**	90.9	234.4	210.5	–	535.8
Derivative financial instruments	**102.5**	**7.8**	**12.9**	**–**	**123.2**	68.7	13.2	10.9	–	92.8
Other borrowed funds	**358.4**	**–**	**–**	**–**	**358.4**	358.1	–	–	–	358.1
Other liabilities	**109.3**	**0.1**	**0.2**	**–**	**109.6**	99.4	2.2	0.9	–	102.5
Accruals and deferred income	**30.3**	**–**	**–**	**–**	**30.3**	32.5	–	–	–	32.5
Provisions	**14.7**	**–**	**–**	**–**	**14.7**	8.8	–	–	–	8.8
Current tax liabilities	**–**	**–**	**–**	**–**	**–**	2.9	–	–	–	2.9
Deferred tax liabilities	**22.5**	**–**	**–**	**–**	**22.5**	0.7	–	–	–	0.7
Total liabilities	**15,049.1**	**127.5**	**503.5**	**7.6**	**15,687.7**	11,095.8	380.6	384.3	2.8	11,863.5
Net on-balance sheet position	**568.9**	**61.3**	**75.4**	**10.3**	**715.9**	670.6	(8.6)	(12.6)	10.9	660.3

At 10 January 2009 the Group's open position was £0.7m (2007: £2.9m) representing a potential loss of £nil given a 3% depreciation in sterling (2007: £0.1m). The Group's open position is monitored against limits in addition to limits in place on individual currencies. All figures are in £ sterling equivalent.

All amounts are stated in £m unless otherwise indicated

Interest rate risk

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/or the maturity date.

2008 Group	**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	**1,704.8**	**172.0**	**–**	**–**	**–**	**9.9**	**–**	**1,886.7**
Loans and advances to customers	**7,837.4**	**298.6**	**331.0**	**1,500.9**	**338.4**	**–**	**–**	**10,306.3**
Debt securities and equity shares	**1,919.2**	**263.1**	**20.6**	**20.1**	**8.7**	**13.0**	**–**	**2,244.7**
Other assets	**164.6**	**–**	**–**	**–**	**–**	**325.1**	**36.7**	**526.4**
Loans to trading book	**1 0.5**	**–**	**–**	**–**	**–**	**(2.0)**	**(8.5)**	**–**
Total assets	**11,636.5**	**733.7**	**351.6**	**1,521.0**	**347.1**	**346.0**	**28.2**	**14,964.1**
Liabilities and equity								
Deposits by banks	**1,064.5**	**1.5**	**1.0**	**–**	**–**	**5.3**	**–**	**1,072.3**
Customer accounts	**9,035.9**	**273.8**	**695.0**	**297.9**	**–**	**1,606.2**	**–**	**11,908.8**
Debt securities in issue	**471.0**	**92.0**	**5.0**	**–**	**–**	**–**	**–**	**568.0**
Other borrowed funds	**–**	**–**	**–**	**–**	**360.0**	**(1.6)**	**–**	**358.4**
Other liabilities	**–**	**–**	**–**	**–**	**–**	**247.7**	**28.2**	**275.9**
Equity	**–**	**–**	**–**	**–**	**–**	**780.7**	**–**	**780.7**
Total liabilities and equity	**10,571.4**	**367.3**	**701.0**	**297.9**	**360.0**	**2,638.3**	**28.2**	**14,964.1**
Derivatives	**(1,770.1)**	**75.0**	**311.2**	**1,144.0**	**239.9**	**–**	**–**	
Interest rate sensitivity gap	**(705.0)**	**441.4**	**(38.2)**	**2,367.1**	**227.0**	**(2,292.3)**	**–**	
Cumulative gap	**(705.0)**	**(263.6)**	**(301.8)**	**2,065.3**	**2,292.3**	**–**	**–**	

2007 Group	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	1,192.8	–	–	–	–	11.2	–	1,204.0
Loans and advances to customers	6,386.9	278.0	491.2	1,537.4	315.5	–	–	9,009.0
Debt securities and equity shares	1,727.8	350.2	125.4	219.9	7.6	8.8	–	2,439.7
Other assets	173.0	–	–	–	–	250.7	10.5	434.2
Loans to trading book	0.6	–	–	–	–	(2.0)	1.4	–
Total assets	9,481.1	628.2	616.6	1,757.3	323.1	268.7	11.9	13,086.9
Liabilities and equity								
Deposits by banks	652.2	1.5	2.0	–	–	5.6	–	661.3
Customer accounts	8,572.3	61.3	224.0	178.9	–	1,523.0	–	10,559.5
Debt securities in issue	444.2	91.6	–	–	–	–	–	535.8
Other borrowed funds	–	–	–	–	360.0	(1.9)	–	358.1
Other liabilities	–	–	–	–	–	243.4	11.9	255.3
Equity	–	–	–	–	–	716.9	–	716.9
Total liabilities and equity	9,668.7	154.4	226.0	178.9	360.0	2,487.0	11.9	13,086.9
Derivatives	(918.6)	(168.7)	–	822.3	265.0	–	–	
Interest rate sensitivity gap	(1,106.2)	305.1	390.6	2,400.7	228.1	(2,218.3)	–	
Cumulative gap	(1,106.2)	(801.1)	(410.5)	1,990.2	2,218.3	–	–	

All amounts are stated in £m unless otherwise indicated

2008 Bank	**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	**1,715.6**	**172.0**	**–**	**–**	**–**	**9.9**	**–**	**1,897.5**
Loans and advances to customers	**8,742.6**	**296.8**	**325.0**	**1,494.6**	**310.8**	**–**	**–**	**11,169.8**
Debt securities and equity shares	**1,603.7**	**177.2**	**0.5**	**20.1**	**8.7**	**13.0**	**–**	**1,823.2**
Other assets	**1,136.4**	**–**	**–**	**–**	**–**	**340.0**	**36.7**	**1,513.1**
Loans to trading book	**10.5**	**–**	**–**	**–**	**–**	**(2.0)**	**(8.5)**	**–**
Total assets	**13,208.8**	**646.0**	**325.5**	**1,514.7**	**319.5**	**360.9**	**28.2**	**16,403.6**
Liabilities and equity								
Deposits by banks	**1,064.5**	**1.5**	**1.0**	**–**	**–**	**5.3**	**–**	**1,072.3**
Customer accounts	**10,566.6**	**272.9**	**692.5**	**297.9**	**–**	**1,558.8**	**–**	**13,388.7**
Debt securities in issue	**471.0**	**92.0**	**5.0**	**–**	**–**	**–**	**–**	**568.0**
Other borrowed funds	**–**	**–**	**–**	**–**	**360.0**	**(1.6)**	**–**	**358.4**
Other liabilities	**–**	**–**	**–**	**–**	**–**	**272.1**	**28.2**	**300.3**
Equity	**–**	**–**	**–**	**–**	**–**	**715.9**	**–**	**715.9**
Total liabilities and equity	**12,102.1**	**366.4**	**698.5**	**297.9**	**360.0**	**2,550.5**	**28.2**	**16,403.6**
Derivatives	**(1,660.1)**	**75.0**	**286.1**	**1,059.0**	**240.0**	**–**	**–**	
Interest rate sensitivity gap	**(553.4)**	**354.6**	**(86.9)**	**2,275.8**	**199.5**	**(2,189.6)**	**–**	
Cumulative gap	**(553.4)**	**(198.8)**	**(285.7)**	**1,990.1**	**2,189.6**	**–**	**–**	

2007 Bank	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	1,200.0	–	–	–	–	11.2	–	1,211.2
Loans and advances to customers	6,304.4	277.7	490.5	1,534.2	307.6	–	–	8,914.4
Debt securities and equity shares	1,417.7	215.2	125.4	219.9	7.5	8.8	–	1,994.5
Other assets	175.5	–	–	–	–	217.7	10.5	403.7
Loans to trading book	0.6	–	–	–	–	(2.0)	1.4	–
Total assets	9,098.2	492.9	615.9	1,754.1	315.1	235.7	11.9	12,523.8
Liabilities and equity								
Deposits by banks	652.2	1.5	2.0	–	–	5.6	–	661.3
Customer accounts	8,126.7	61.3	224.0	178.9	–	1,477.2	–	10,068.1
Debt securities in issue	444.2	91.6	–	–	–	–	–	535.8
Other borrowed funds	–	–	–	–	360.0	(1.9)	–	358.1
Other liabilities	–	–	–	–	–	228.3	11.9	240.2
Equity	–	–	–	–	–	660.3	–	660.3
Total liabilities and equity	9,223.1	154.4	226.0	178.9	360.0	2,369.5	11.9	12,523.8
Derivatives	(838.6)	(168.7)	(10.0)	752.3	265.0	–	–	
Interest rate sensitivity gap	(963.5)	169.8	379.9	2,327.5	220.1	(2,133.8)	–	
Cumulative gap	(963.5)	(793.7)	(413.8)	1,913.7	2,133.8	–	–	

The period end position shown above is regarded as materially representative of the Group 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

Liquidity risk arises from the timing of cash flows generated from the Group's assets, liabilities and off-balance sheet instruments. The Group's liquidity management policies are reviewed and approved annually by the Risk Management Committee and compliance reviewed monthly by ALCO.

Liquidity risk arising from the structure of the balance sheet (structural liquidity) is managed to policies developed by ALCO. Liquidity risk is defined as the Board approved survival period under stress scenarios. The Bank undertakes the following stress tests on a weekly basis:

- A severe stress which uses double the worst gross outflows experienced over the last 3 years.
- A double stress scenario which models a combination of a Bank specific event (run on the Bank) and market wide disruption.
- A Treasury stress test which assumes restricted access to wholesale market funding.

The Bank's liquidity management framework is designed in line with industry guidelines, including IIF (Institute of International Finance) and BIS (Bank for International Settlements) recommendations, and is being developed in response to emerging FSA requirements.

The Bank manages liquidity risk by applying:

- A rigorous control process embedded in the Bank's operations;
- Robust liquidity management with:
  - net outflows monitored to ensure they are within FSA limits;
  - maintenance of a well diversified deposit base;
  - management of stocks: high quality primary liquidity including cash, and secondary liquidity including certificates of deposit; and
  - target funding ratio and funding ratios translated into Retail and Corporate targets.

Day-to-day cash flow (tactical liquidity) is managed by Treasury within guidelines laid down by ALCO and in accordance with the standards established for all banks by banking regulators.

The Bank currently funds in excess of 100% of retail assets by retail deposits, ensuring there is no over reliance on wholesale funding. There is a target funding ratio set in line with the Board approved strategic plan, which is being met. The Group's structural liquidity risk management is therefore retail based and is dependent on behavioural analysis of both customer demand and deposit and loan drawdown profiles by product category based on experience over the last 10 years. The behaviour of retail products is reviewed by ALCO on a quarterly basis. In addition the Group has maturity mismatch limits to control the exposure to longer term mismatches.

The Bank's liquidity position is monitored on a daily basis and reported to ALCO each month. Treasury holds a pool of liquid assets of £775m on behalf of the Bank, and actionable management actions are in place to provide an additional £775m of liquidity. These sources of liquidity totalling £1.5bn are held in order to be available to meet unexpected outflows.

Marketable assets are maintained as a liquidity pool against potential retail outflows; the asset quality of these is controlled via credit limits. Concentration limits are set by issuer name and holding per bond to ensure diversity of assets.

A Covered Bond Programme has been developed to provide access to the Bank of England Special Liquidity Scheme and the Bank has issued a £1bn Covered Bond from its £3bn Programme, which was bought back on to the Bank's balance sheet to enable it to be used as collateral for funding if required in a stress event. Until access to other government schemes is secured the Bank of England Liquidity Scheme has been drawn to ensure continuing access to this scheme.

The Bank is eligible for the Government Guarantee Scheme, which would enable the Bank to issue debt with maturities up to 3 years under a government guarantee. The scheme will only be used if cost effective when viewed against other sources of funding.

Liquidity gap

The following table analyses assets and liabilities into relevant maturity groupings based on the remaining period of the balance sheet date to the contractual maturity date.

The Bank manages liquidity on a behavioural rather than contractual basis of reflecting where actual behaviour differs from contractual maturity:

- Retail and Corporate deposit bases are very stable, with deposits being attracted to the Bank by good customer service and its ethical policy. As a result, the deposit base remains stable whereas the contractual maturity is immediate for instant access deposits.
- Personal loan and visa balances are repaid earlier than their contractual maturity date.

These behavioural adjustments are based on historical experience of customer behaviour over a period of up to 10 years.

All amounts are stated in £m unless otherwise indicated

As the Bank manages liquidity on a behavioural basis, both the liquidity gap analysis and cash flow maturity analysis have been disclosed on a contractual and behavioural basis.

2008 Group	**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**
Assets							
Loans and advances to banks	**–**	**1,704.8**	**172.0**	**–**	**9.9**	**–**	**1,886.7**
Loans and advances to customers	**781.6**	**2,577.8**	**712.7**	**1,801.1**	**4,621.0**	**(187.9)**	**10,306.3**
Debt securities	**–**	**1,210.1**	**352.0**	**656.5**	**13.2**	**–**	**2,231.8**
Other assets	**367.6**	**–**	**–**	**–**	**–**	**171.7**	**539.3**
	1,149.2	**5,492.7**	**1,236.7**	**2,457.6**	**4,644.1**	**(16.2)**	**14,964.1**
Liabilities							
Deposits by banks	**162.1**	**907.7**	**2.5**	**–**	**–**	**–**	**1,072.3**
Customer accounts	**8,933.8**	**1,770.7**	**907.4**	**296.9**	**–**	**–**	**11,908.8**
Debt securities in issue	**–**	**472.0**	**96.0**	**–**	**–**	**–**	**568.0**
Other borrowed funds	**–**	**–**	**–**	**–**	**360.0**	**(1.6)**	**358.4**
Other liabilities	**117.9**	**–**	**–**	**–**	**–**	**158.0**	**275.9**
	9,213.8	**3,150.4**	**1,005.9**	**296.9**	**360.0**	**156.4**	**14,183.4**
Net liquidity gap – contractual basis	**(8,064.6)**	**2,342.3**	**230.8**	**2,160.7**	**4,284.1**	**(172.6)**	**780.7**
Behavioural adjustments:							
Loans and advances to customers	**–**	**(44.5)**	**(74.4)**	**(539.5)**	**658.4**	**–**	**–**
Customers accounts	**7,849.0**	**(678.9)**	**(1,061.9)**	**(6,108.2)**	**–**	**–**	**–**
Net liquidity gap – behavioural basis	**(215.6)**	**1,618.9**	**(905.5)**	**(4,487.0)**	**4,942.5**	**(172.6)**	**780.7**

2007 Group	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
Assets							
Loans and advances to banks	2.7	1,190.0	–	–	11.3	–	1,204.0
Loans and advances to customers	732.5	2,174.7	664.4	1,508.2	4,089.9	(160.7)	9,009.0
Debt securities	–	1,015.3	511.2	818.8	85.6	–	2,430.9
Other assets	261.1	–	–	–	–	181.9	443.0
	996.3	4,380.0	1,175.6	2,327.0	4,186.8	21.2	13,086.9
Liabilities							
Deposits by banks	46.1	611.7	3.5	–	–	–	661.3
Customer accounts	8,118.9	1,979.5	282.3	178.8	–	–	10,559.5
Debt securities in issue	–	444.2	91.6	–	–	–	535.8
Other borrowed funds	–	–	–	–	360.0	(1.9)	358.1
Other liabilities	92.3	–	–	–	–	163.0	255.3
	8,257.3	3,035.4	377.4	178.8	360.0	161.1	12,370.0
Net liquidity gap – contractual basis	(7,261.0)	1,344.6	798.2	2,148.2	3,826.8	(139.9)	716.9
Behavioural adjustments:							
Loans and advances to customers	(116.9)	(218.0)	(535.4)	(4.4)	874.7	–	–
Customers accounts	7,914.0	(646.7)	(1,082.3)	(6,185.0)	–	–	–
Net liquidity gap – behavioural basis	536.1	479.9	(819.5)	(4,041.2)	4,701.5	(139.9)	716.9

All amounts are stated in £m unless otherwise indicated

2008 Bank	**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**
Assets							
Loans and advances to banks	**–**	**1,715.6**	**172.0**	**–**	**9.9**	**–**	**1,897.5**
Loans and advances to customers	**764.5**	**3,594.7**	**698.6**	**1,767.6**	**4,531.4**	**(187.0)**	**11,169.8**
Debt securities	**–**	**894.5**	**246.1**	**656.4**	**13.2**	**–**	**1,810.2**
Other assets	**398.0**	**–**	**–**	**–**	**–**	**1,128.1**	**1,526.1**
	1,162.5	**6,204.8**	**1,116.7**	**2,424.0**	**4,554.5**	**941.1**	**16,403.6**
Liabilities							
Deposits by banks	**162.1**	**907.7**	**2.5**	**–**	**–**	**–**	**1,072.3**
Customer accounts	**8,504.2**	**3,683.5**	**904.2**	**296.8**	**–**	**–**	**13,388.7**
Debt securities in issue	**–**	**472.0**	**96.0**	**–**	**–**	**–**	**568.0**
Other borrowed funds	**–**	**–**	**–**	**–**	**360.0**	**(1.6)**	**358.4**
Other liabilities	**123.2**	**–**	**–**	**–**	**–**	**177.1**	**300.3**
	8,789.5	**5,063.2**	**1,002.7**	**296.8**	**360.0**	**175.5**	**15,687.7**
Net liquidity gap – contractual basis	**(7,627.0)**	**1,141.6**	**114.0**	**2,127.2**	**4,194.5**	**765.6**	**715.9**
Behavioural adjustments:							
Loans and advances to customers	**–**	**(44.5)**	**(74.4)**	**(539.5)**	**658.4**	**–**	**–**
Customers accounts	**7,634.2**	**(464.1)**	**(1,061.9)**	**(6,108.2)**	**–**	**–**	**–**
Net liquidity gap – behavioural basis	**7.2**	**633.0**	**(1,022.3)**	**(4,520.5)**	**4,852.9**	**765.6**	**715.9**

2007 Bank	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
Assets							
Loans and advances to banks	2.7	1,197.2	–	–	11.3	–	1,211.2
Loans and advances to customers	712.8	2,196.3	659.8	1,488.9	4,017.3	(160.7)	8,914.4
Debt securities	–	705.2	376.1	818.8	85.6	–	1,985.7
Other assets	261.4	–	–	–	–	151.1	412.5
	976.9	4,098.7	1,035.9	2,307.7	4,114.2	(9.6)	12,523.8
Liabilities							
Deposits by banks	46.1	611.7	3.5	–	–	–	661.3
Customer accounts	7,758.9	1,853.2	277.2	178.8	–	–	10,068.1
Debt securities in issue	–	444.2	91.6	–	–	–	535.8
Other borrowed funds	–	–	–	–	360.0	(1.9)	358.1
Other liabilities	92.8	–	–	–	–	147.4	240.2
	7,897.8	2,909.1	372.3	178.8	360.0	145.5	11,863.5
Net liquidity gap – contractual basis	(6,920.9)	1,189.6	663.6	2,128.9	3,754.2	(155.1)	660.3
Behavioural adjustments:							
Loans and advances to customers	(116.9)	(218.0)	(535.4)	(4.4)	874.7	–	–
Customers accounts	7,734.0	(466.7)	(1,082.3)	(6,185.0)	–	–	–
Net liquidity gap – behavioural basis	696.2	504.9	(954.1)	(4,060.5)	4,628.9	(155.1)	660.3

All amounts are stated in £m unless otherwise indicated

Gross contractual cash flow maturity analysis

The following is an analysis of gross contractual cash flows of financial liabilities held at the balance sheet date.

2008 Group	**Carrying value**	**Gross nominal (inflow)/outflow**	**less than 1 month**	**1-3 months**	**3-12 months**	**1-5 years**	**Over 5 years**
Non-derivative liabilities							
Deposits by banks	**1,072.3**	**1,073.5**	**979.6**	**91.4**	**2.5**	**–**	**–**
Customer accounts	**11,908.8**	**11,960.5**	**9,768.1**	**925.3**	**942.2**	**324.9**	**–**
Debt securities	**568.0**	**571.8**	**201.6**	**274.0**	**96.2**	**–**	**–**
Other borrowed funds	**358.4**	**508.1**	**–**	**8.8**	**14.0**	**91.2**	**394.1**
	13,907.5	**14,113.9**	**10,949.3**	**1,299.5**	**1,054.9**	**416.1**	**394.1**
Derivative liabilities							
Net outflow	**117.9**	**117.9**	**117.9**	**–**	**–**	**–**	**–**
	14,025.4	**14,231.8**	**11,067.2**	**1,299.5**	**1,054.9**	**416.1**	**394.1**
Other liabilities	**158.0**	**–**	**–**	**–**	**–**	**–**	**–**
Total recognised liabilities	**14,183.4**	**14,231.8**	**11,067.2**	**1,299.5**	**1,054.9**	**416.1**	**394.1**
Unrecognised loan commitments	**5,503.8**	**5,503.8**	**5,480.8**	**7.0**	**15.6**	**0.4**	**–**
Total	**19,687.2**	**19,735.6**	**16,548.0**	**1,306.5**	**1,070.5**	**416.5**	**394.1**

2007 Group	Carrying value	Gross nominal (inflow)/outflow	less than 1 month	1-3 months	3-12 months	1-5 years	Over 5 years
Non-derivative liabilities							
Deposits by banks	661.3	664.0	599.3	61.1	3.6	–	–
Customer accounts	10,559.5	10,637.0	9,882.2	223.9	324.7	206.2	–
Debt securities in issue	535.8	540.5	246.8	202.1	91.6	–	–
Other borrowed funds	358.1	514.5	–	8.8	11.2	91.2	403.3
	12,114.7	12,356.0	10,728.3	495.9	431.1	297.4	403.3
Derivative liabilities							
Net outflow	92.3	92.3	92.3	–	–	–	–
	12,207.0	12,448.3	10,820.6	495.9	431.1	297.4	403.3
Other liabilities	163.0	–	–	–	–	–	–
Total recognised liabilities	12,370.0	12,448.3	10,820.6	495.9	431.1	297.4	403.3
Unrecognised loan commitments	6,371.7	6,371.7	6,301.8	7.9	14.9	47.1	–
Total	18,741.7	18,820.0	17,122.4	503.8	446.0	344.5	403.3

All amounts are stated in £m unless otherwise indicated

2008 Bank	**Carrying value**	**Gross nominal (inflow)/outflow**	**less than 1 month**	**1-3 months**	**3-12 months**	**1-5 years**	**Over 5 years**
Non-derivative liabilities							
Deposits by banks	**1,072.3**	**1,073.5**	**979.6**	**91.4**	**2.5**	**–**	**–**
Customer accounts	**13,388.7**	**13,455.1**	**11,397.8**	**795.4**	**937.0**	**324.9**	**–**
Debt securities in issue	**568.0**	**571.8**	**201.6**	**274.0**	**96.2**	**–**	**–**
Other borrowed funds	**358.4**	**508.1**	**–**	**8.8**	**14.0**	**91.2**	**394.1**
	15,387.4	**15,608.5**	**12,579.0**	**1,169.6**	**1,049.7**	**416.1**	**394.1**
Derivative liabilities							
Net outflow	**123.2**	**123.2**	**123.2**	**–**	**–**	**–**	**–**
	15,510.6	**15,731.7**	**12,702.2**	**1,169.6**	**1,049.7**	**416.1**	**394.1**
Other liabilities	**177.1**	**–**	**–**	**–**	**–**	**–**	**–**
Total recognised liabilities	**15,687.7**	**15,731.7**	**12,702.2**	**1,169.6**	**1,049.7**	**416.1**	**394.1**
Unrecognised loan commitments	**5,495.9**	**5,495.9**	**5,472.9**	**7.0**	**15.6**	**0.4**	**–**
Total	**21,183.6**	**21,227.6**	**18,175.1**	**1,176.6**	**1,065.3**	**416.5**	**394.1**

2007 Bank	Carrying value	Gross nominal (inflow)/outflow	less than 1 month	1-3 months	3-12 months	1-5 years	Over 5 years
Non-derivative liabilities							
Deposits by banks	661.3	664.0	599.3	61.1	3.6	–	–
Customer accounts	10,068.1	10,141.1	9,451.5	164.0	319.4	206.2	–
Debt securities in issue	535.8	540.5	246.8	202.1	91.6	–	–
Other borrowed funds	358.1	514.5	–	8.8	11.2	91.2	403.3
	11,623.3	11,860.1	10,297.6	436.0	425.8	297.4	403.3
Derivative liabilities							
Net outflow	92.8	92.8	92.8	–	–	–	–
	11,716.1	11,952.9	10,390.4	436.0	425.8	297.4	403.3
Other liabilities	147.4	–	–	–	–	–	–
Total recognised liabilities	11,863.5	11,952.9	10,390.4	436.0	425.8	297.4	403.3
Unrecognised loan commitments	6,364.5	6,364.5	6,294.6	7.9	14.9	47.1	–
Total	18,228.0	18,317.4	16,685.0	443.9	440.7	344.5	403.3

All amounts are stated in £m unless otherwise indicated

Gross expected cashflow maturity analysis – behavioural

The following is an analysis of gross expected cash flow maturity. Liquidity cash flows are managed on a behavioural basis reflecting the actual behaviour of customers using the same assumptions defined on page 68 for liquidity gap analysis based on historic cash flow profiles over a period of 10 years.

2008 **Group**	**Carrying value**	**Gross nominal (inflow)/outflow**	**less than 1 month**	**1-3 months**	**3-12 months**	**1-5 years**	**Over 5 years**
Non-derivative liabilities							
Deposits by banks	**1,072.3**	**1,073.5**	**979.6**	**91.4**	**2.5**	**–**	**–**
Customer accounts	**11,908.8**	**11,960.5**	**1,931.3**	**1,163.6**	**2,054.6**	**6,811.0**	**–**
Debt securities	**568.0**	**571.8**	**201.6**	**274.0**	**96.2**	**–**	**–**
Other borrowed funds	**358.4**	**508.1**	**–**	**8.8**	**14.0**	**91.2**	**394.1**
	13,907.5	**14,113.9**	**3,112.5**	**1,537.8**	**2,167.3**	**6,902.2**	**394.1**
Derivative liabilities							
Net outflow	**117.9**	**117.9**	**117.9**	**–**	**–**	**–**	**–**
	14,025.4	**14,231.8**	**3,230.4**	**1,537.8**	**2,167.3**	**6,902.2**	**394.1**
Other liabilities	**158.0**	**–**	**–**	**–**	**–**	**–**	**–**
Total recognised liabilities	**14,183.4**	**14,231.8**	**3,230.4**	**1,537.8**	**2,167.3**	**6,902.2**	**394.1**
Unrecognised loan commitments	**5,503.8**	**5,503.8**	**5,480.8**	**7.0**	**15.6**	**0.4**	**–**
Total	**19,687.2**	**19,735.6**	**8,711.2**	**1,544.8**	**2,182.9**	**6,902.6**	**394.1**

2007 **Bank**	Carrying value	Gross nominal (inflow)/outflow	less than 1 month	1-3 months	3-12 months	1-5 years	Over 5 years
Non-derivative liabilities							
Deposits by banks	661.3	664.0	599.3	61.1	3.6	–	–
Customer accounts	10,559.5	10,637.0	2,648.9	491.8	1,235.7	6,260.6	–
Debt securities in issue	535.8	540.5	246.8	202.1	91.6	–	–
Other borrowed funds	358.1	514.5	–	8.8	11.2	91.2	403.3
	12,114.7	12,356.0	3,495.0	763.8	1,342.1	6,351.8	403.3
Derivative liabilities							
Net outflow	92.3	92.3	92.3	–	–	–	–
	12,207.0	12,448.3	3,587.3	763.8	1,342.1	6,351.8	403.3
Other liabilities	163.0	–	–	–	–	–	–
Total recognised liabilities	12,370.0	12,448.3	3,587.3	763.8	1,342.1	6,351.8	403.3
Unrecognised loan commitments	6,371.7	6,371.7	6,301.8	7.9	14.9	47.1	–
Total	18,741.7	18,820.0	9,889.1	771.7	1,357.0	6,398.9	403.3

2008 **Bank**	**Carrying value**	**Gross nominal (inflow)/outflow**	**less than 1 month**	**1-3 months**	**3-12 months**	**1-5 years**	**Over 5 years**
Non-derivative liabilities							
Deposits by banks	**1,072.3**	**1,073.5**	**979.6**	**91.4**	**2.5**	**–**	**–**
Customer accounts	**13,388.7**	**13,455.1**	**3,560.9**	**1,033.8**	**2,049.4**	**6,811.0**	**–**
Debt securities in issue	**568.0**	**571.8**	**201.6**	**274.0**	**96.2**	**–**	**–**
Other borrowed funds	**358.4**	**508.1**	**–**	**8.8**	**14.0**	**91.2**	**394.1**
	15,387.4	**15,608.5**	**4,742.1**	**1,408.0**	**2,162.1**	**6,902.2**	**394.1**
Derivative liabilities							
Net outflow	**123.2**	**123.2**	**123.2**	**–**	**–**	**–**	**–**
	15,510.6	**15,731.7**	**4,865.3**	**1,408.0**	**2,162.1**	**6,902.2**	**394.1**
Other liabilities	**177.1**	**–**	**–**	**–**	**–**	**–**	**–**
Total recognised liabilities	**15,687.7**	**15,731.7**	**4,865.3**	**1,408.0**	**2,162.1**	**6,902.2**	**394.1**
Unrecognised loan commitments	**5,495.9**	**5,495.9**	**5,472.9**	**7.0**	**15.6**	**0.4**	**–**
Total	**21,183.6**	**21,227.6**	**10,338.2**	**1,415.0**	**2,177.7**	**6,902.6**	**394.1**

All amounts are stated in £m unless otherwise indicated

2007 **Bank**	Carrying value	Gross nominal (inflow)/outflow	less than 1 month	1-3 months	3-12 months	1-5 years	Over 5 years
Non-derivative liabilities							
Deposits by banks	661.3	663.9	599.3	61.1	3.5	–	–
Customer accounts	10,068.1	10,141.1	2,218.2	431.9	230.4	6,260.6	–
Debt securities in issue	535.8	540.4	246.8	202.0	91.6	–	–
Other borrowed funds	358.1	514.5	–	8.8	11.2	91.2	403.3
	11,623.3	11,859.9	3,064.3	703.8	1,336.7	6,351.8	403.3
Derivative liabilities							
Net outflow	92.8	92.8	92.8	–	–	–	–
	11,716.1	11,952.7	3,157.1	703.8	1,336.7	6,351.8	403.3
Other liabilities	147.4	–	–	–	–	–	–
Total recognised liabilities	11,863.5	11,952.7	3,157.1	703.8	1,336.7	6,351.8	403.3
Unrecognised loan commitments	6,364.5	6,364.5	6,294.6	7.9	14.9	47.1	–
Total	18,228.0	18,317.2	9,451.7	711.7	1,351.6	6,398.9	403.3

Demand deposits are shown as less than one month in the analysis above.

Fair values of financial assets and liabilities

The table below sets out a comparison of the book value and the fair value at 10 January 2009 of all of the Group's financial instruments, where there is no significant difference between book value and carrying value.

	Group		**Bank**	
2008	**Carrying value**	**Fair value**	**Carrying value**	**Fair value**
Assets				
Loans and advances to banks	**1,886.7**	**1,885.3**	**1,897.5**	**1,896.1**
Loans and advances to customers	**10,306.3**	**10,168.1**	**11,169.8**	**11,030.3**
Debt securities	**2,231.7**	**2,220.6**	**1,810.2**	**1,799.1**
Liabilities				
Customer accounts	**11,908.8**	**11,945.2**	**13,388.7**	**13,425.1**
Debt securities in issue	**568.0**	**569.1**	**568.0**	**569.1**
Other borrowed funds	**358.4**	**324.6**	**358.4**	**324.6**

	Group		Bank	
2007	Carrying value	Fair value	Carrying value	Fair value
Assets				
Loans and advances to banks	1,204.0	1,203.1	1,211.2	1,210.3
Loans and advances to customers	9,009.0	8,746.7	8,914.4	8,625.9
Debt securities	2,430.9	2,430.9	1,985.7	1,985.7
Liabilities				
Customer accounts	10,559.5	10,561.4	10,068.1	10,070.0
Debt securities in issue	535.8	539.2	535.8	539.2
Other borrowed funds	358.1	357.5	358.1	357.5

(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.

A credit loss adjustment has been applied based-on expected loss amounts derived from the Bank's regulatory capital calculations.

(b) Loans and advances to customers

Fixed rate loans and advances to customers are revalued to fair value based on future interest cash flows (at funding rates) and principal cash flows discounted using the zero coupon rate. Forecast principal repayments are based on redemption at the earlier of maturity or repricing date with some overlay for historic behavioural experience where relevant. The eventual timing of future cash flows may be different from the forecast due to unpredictable customer behaviour. It is assumed there is no fair value adjustment required in respect of interest rate movement on variable rate assets. A credit loss adjustment has been applied based on expected loss amounts derived from the Bank's regulatory capital calculations.

All amounts are stated in £m unless otherwise indicated

(c) 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.

(d) 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.

(e) 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.

Additionally, derivatives are measured at fair value.

(f) 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.

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 table below analyses financial instruments by measurement basis as detailed by IAS 39.

Balance sheet categories	Trading	Designated at fair value	Loans and receivables	Available for sale	Other amortised cost	Cash flow hedges	Total
2008							
Group							
Assets							
Cash and balances at central banks	–	–	164.7	–	–	–	164.7
Loans and advances to banks	–	–	1,886.7	–	–	–	1,886.7
Loans and advances to customers	–	35.8	10,270.5	–	–	–	10,306.3
Debt securities	–	–	123.4	2,108.3	–	–	2,231.7
Derivative financial instruments	71.3	19.7	–	–	–	112.0	203.0
Equity shares	–	–	–	13.0	–	–	13.0
Total financial assets	71.3	55.5	12,445.3	2,121.3	–	112.0	14,805.4
Non financial assets							158.7
Total assets							14,964.1
Liabilities							
Deposits by banks	–	–	–	–	1,072.3	–	1,072.3
Deposits from customers	–	–	–	–	11,908.8	–	11,908.8
Debt securities in issue	–	–	–	–	568.0	–	568.0
Derivative financial instruments	62.5	24.4	–	–	–	31.0	117.9
Other borrowed funds	–	–	–	–	358.4	–	358.4
Total financial liabilities	62.5	24.4	–	–	13,907.5	31.0	14,025.4
Non financial liabilities							158.0
Total liabilities							14,183.4
Capital and reserves							780.7
Total liabilities and equity							14,964.1

All amounts are stated in £m unless otherwise indicated

Balance sheet categories	Trading	Designated at fair value	Loans and receivables	Available for sale	Other amortised cost	Cash flow hedges	Total
2007							
Group							
Assets							
Cash and balances at central banks	–	–	172.9	–	–	–	172.9
Loans and advances to banks	–	–	1,204.0	–	–	–	1,204.0
Loans and advances to customers	–	29.1	8,979.9	–	–	–	9,009.0
Debt securities	–	6.9	–	2,424.0	–	–	2,430.9
Derivative financial instruments	9.6	67.9	–	–	–	10.7	88.2
Equity shares	–	–	–	8.8	–	–	8.8
Total financial assets	9.6	103.9	10,356.8	2,432.8	–	10.7	12,913.8
Non financial assets							173.1
Total assets							13,086.9
Liabilities							
Deposits by banks	–	–	–	–	661.3	–	661.3
Deposits from customers	–	–	–	–	10,559.5	–	10,559.5
Debt securities in issue	–	–	–	–	535.8	–	535.8
Derivative financial instruments	8.0	71.9	–	–	–	12.4	92.3
Other borrowed funds	–	–	–	–	358.1	–	358.1
Total financial liabilities	8.0	71.9	–	–	12,114.7	12.4	12,207.0
Non financial liabilities							163.0
Total liabilities							12,370.0
Capital and reserves							716.9
Total liabilities and equity							13,086.9

Balance sheet categories	**Trading**	**Designated at fair value**	**Loans and receivables**	**Available for sale**	**Other amortised cost**	**Cash flow hedges**	**Total**
2008							
Bank							
Assets							
Cash and balances at central banks	**–**	**–**	**164.7**	**–**	**–**	**–**	**164.7**
Loans and advances to banks	**–**	**–**	**1,897.5**	**–**	**–**	**–**	**1,897.5**
Loans and advances to customers	**–**	**35.8**	**11,134.0**	**–**	**–**	**–**	**11,169.8**
Debt securities	**–**	**–**	**123.4**	**1,686.8**	**–**	**–**	**1,810.2**
Derivative financial instruments	**76.7**	**50.1**	**–**	**–**	**–**	**106.6**	**233.4**
Equity shares	**–**	**–**	**–**	**13.0**	**–**	**–**	**13.0**
Total financial assets	**76.7**	**85.9**	**13,319.6**	**1,699.8**	**–**	**106.6**	**15,288.6**
Non financial assets							**1,115.0**
Total assets							**16,403.6**
Liabilities							
Deposits by banks	**–**	**–**	**–**	**–**	**1,072.3**	**–**	**1,072.3**
Deposits from customers	**–**	**1,996.3**	**–**	**–**	**11,392.4**	**–**	**13,388.7**
Debt securities in issue	**–**	**–**	**–**	**–**	**568.0**	**–**	**568.0**
Derivative financial instruments	**67.8**	**24.4**	**–**	**–**	**–**	**31.0**	**123.2**
Other borrowed funds	**–**	**–**	**–**	**–**	**358.4**	**–**	**358.4**
Total financial liabilities	**67.8**	**2,020.7**	**–**	**–**	**13,391.1**	**31.0**	**15,510.6**
Non financial liabilities							**177.1**
Total liabilities							**15,687.7**
Capital and reserves							**715.9**
Total liabilities and equity							**16,403.6**

All amounts are stated in £m unless otherwise indicated

Balance sheet categories	Trading	Designated at fair value	Loans and receivables	Available for sale	Other amortised cost	Cash flow hedges	Total
2007							
Bank							
Assets							
Cash and balances at central banks	–	–	172.9	–	–	–	172.9
Loans and advances to banks	–	–	1,211.2	–	–	–	1,211.2
Loans and advances to customers	–	29.1	8,885.3	–	–	–	8,914.4
Debt securities	–	6.9	–	1,978.8	–	–	1,985.7
Derivative financial instruments	10.5	67.9	–	–	–	10.1	88.5
Equity shares	–	–	–	8.8	–	–	8.8
Total financial assets	10.5	103.9	10,269.4	1,987.6	–	10.1	12,381.5
Non financial assets							142.3
Total assets							12,523.8
Liabilities							
Deposits by banks	–	–	–	–	661.3	–	661.3
Deposits from customers	–	–	–	–	10,068.1	–	10,068.1
Debt securities in issue	–	–	–	–	535.8	–	535.8
Derivative financial instruments	8.7	71.8	–	–	–	12.3	92.8
Other borrowed funds	–	–	–	–	358.1	–	358.1
Total financial liabilities	8.7	71.8	–	–	11,623.3	12.3	11,716.1
Non financial liabilities							147.4
Total liabilities							11,863.5
Capital and reserves							660.3
Total liabilities and equity							12,523.8

Valuation of financial instruments

The following table analyses financial assets at fair value by the three tier valuation appearance as defined within IAS 39.

2008	**Valuation Quoted market prices in active markets**	**Valuation techniques using observable inputs**	**techniques using significant unobservable inputs**	**Total**
Group				
Assets				
Loans and advances to customers	**–**	**22.0**	**13.8**	**35.8**
Debt securities	**2,105.6**	**2.7**	**–**	**2,108.3**
Derivative financial instruments	**–**	**203.0**	**–**	**203.0**
Equity shares	**4.2**	**–**	**8.8**	**13.0**
Total financial assets at fair value	**2,109.8**	**227.7**	**22.6**	**2,360.1**
Liabilities				
Derivative financial instruments	**–**	**117.9**	**–**	**117.9**
Total financial liabilities at fair value	**–**	**117.9**	**–**	**117.9**

All amounts are stated in £m unless otherwise indicated

2007 Group	Quoted market prices in active markets	Valuation techniques using observable inputs	Valuation techniques using significant unobservable inputs	Total
Assets				
Loans and advances to customers	–	25.6	3.5	29.1
Debt securities	2,360.0	70.9	–	2,430.9
Derivative financial instruments	–	88.2	–	88.2
Equity shares	–	–	8.8	8.8
Total financial assets at fair value	2,360.0	184.7	12.3	2,557.0
Liabilities				
Derivative financial instruments	–	92.3	–	92.3
Total financial liabilities at fair value	–	92.3	–	92.3

2008 **Bank**	**Quoted market prices in active markets**	**Valuation techniques using observable inputs**	**Valuation techniques using significant unobservable inputs**	**Total**
Assets				
Loans and advances to customers	**–**	**22.0**	**13.8**	**35.8**
Debt securities	**1,684.1**	**2.7**	**–**	**1,686.8**
Derivative financial instruments	**–**	**203.5**	**29.9**	**233.4**
Equity shares	**4.2**	**–**	**8.8**	**13.0**
Total financial assets at fair value	**1,688.3**	**228.2**	**52.5**	**1,969.0**
Liabilities				
Deposits from customers	**–**	**–**	**1,996.3**	**1,996.3**
Derivative financial instruments	**–**	**123.2**	**–**	**123.2**
Total financial liabilities at fair value	**–**	**123.2**	**1,996.3**	**2,119.5**

2007 **Bank**	Quoted market prices in active markets	Valuation techniques using observable inputs	Valuation techniques using significant unobservable inputs	Total
Assets				
Loans and advances to customers	–	25.6	3.5	29.1
Debt securities	1,914.8	70.9	–	1,985.7
Derivative financial instruments	–	88.5	–	88.5
Equity shares	–	–	8.8	8.8
Total financial assets at fair value	1,914.8	185.0	12.3	2,112.1
Liabilities				
Derivative financial instruments	–	92.8	–	92.8
Total financial liabilities at fair value	–	92.8	–	92.8

All amounts are stated in £m unless otherwise indicated

Movements in fair values of instruments with significant unobservable inputs were:

	Fair value at 12 January 2008	Purchases, sales, settlements	Transfers in/(out)	Profit or loss (including impairment)	Equity (net of impairment)	Fair value at 10 January 2009
Group						
Loans and advances to customers	3.5	8.8	–	1.5	–	13.8
Equity shares	8.8	–	–	–	–	8.8
	12.3	**8.8**	**–**	**1.5**	**–**	**22.6**
Bank						
Loans and advances to customers	3.5	8.8	–	1.5	–	13.8
Debt securities	–	–	–	29.9	–	29.9
Equity shares	8.8	–	–	–	–	8.8
Customers accounts	–	2,026.0	–	(29.7)	–	1,996.3
	12.3	**2,034.8**	**–**	**1.7**	**–**	**2,048.8**

Valuation techniques

Fair values are determined according to the following hierarchy:

(a) Quoted market price: financial instruments with quoted prices for identical instruments in active markets.

The best evidence of fair value is a quoted market price in an actively traded market, and a significant portion of the Bank's financial assets fall into this category.

(b) Valuation technique using observable inputs: financial instruments with quoted prices for similar instruments in active markets or quoted prices for identical or similar instruments in inactive markets and financial instruments valued using models where all significant inputs are observable.

The valuation techniques used to value these instruments employ only observable market data and relate to the following assets:

Loans and advances to customers
Loans and advances to customers include Corporate loans £22.0m (2007: £25.6m) which are fair valued through P&L using observable inputs. Loans held at fair value are valued at the sum of all future expected cash flows, discounted using a yield curve based on observable market inputs.

Debt securities
Debt securities classified under valuation techniques using observable inputs are described in the critical judgements section on page 85.

Derivative financial instruments
OTC (i.e. non-exchange traded) derivatives are valued using valuation models which are based on observable market data. Valuation models calculate the present value of expected future cash flows, based upon 'no-arbitrage' principles. The Bank enters into vanilla FX and interest rate swap derivatives, for which modelling techniques are standard across the industry. Examples of inputs that are generally observable include foreign exchange spot and forward rates, and benchmark interest rate curves.

(c) Valuation technique with significant unobservable inputs: financial instruments valued using models where one or more significant inputs are not observable.

The small proportion of financial assets valued based on significant unobservable inputs are analysed as follows:

Loans and advances to customers
Loans and advances to customers include 25 year fixed rate mortgages £13.8m (2007: £3.5m) which are fair valued through P&L using unobservable inputs. 25 year fixed rate mortgages are valued using future interest cash flows at the fixed customer rate and estimated schedule of customer repayments. Cash flows are discounted at a credit adjusted discount rate; the credit adjustment is based on the average margin of new long dated (5 years or greater) fixed rate business written in the last six months, and subject to quarterly review. The eventual timing of future cash flows may be different from that forecast due to unpredictable customer behaviour, particularly on a 25 year product. The valuation methodology takes account of credit risk and has reduced the valuation by £0.4m in 2008.

Derivative financial instruments
Derivative financial instruments including internal interest rate swaps have been entered into during the year between the Bank and The Covered Bond LLP (LLP).

The purpose of the covered bond swap is to convert the fixed and base rate linked revenue receipts of the covered bond pool of assets to the same LIBOR linked basis as the intercompany loan. Under this swap arrangement the LLP pays to the swap counterparty, in this case The Co-operative Bank p.l.c., the monthly mortgage revenue receipts of the coverpool and receives from the swap counterparty LIBOR plus a contractual spread on the same notional balance; the spread being sufficient to cover the intercompany loan and any expenses.

The swap is valued based on an assumed amortisation profile of the covered bond pool to the bond maturity date (assuming some annual prepayment), an assumed profile of customer receipts over this period, and LIBOR prediction using forward rates. Swap cash flows are discounted to present value using mid yield curve zero coupon rates i.e no adjustment is made for credit losses, nor for transaction or any other costs.

The FV of the swap is based on a valuation model that reflects the mortgage cashflows over a 3 year period using a discount rate based on LIBOR spreads. This derivative eliminates on consolidation.

Equity shares
Primarily, equity shares relate to investments held in Vocalink Limited which are unquoted shares. The valuation of such shares is based on our % shareholding of the most recent public information valuation issued by the company.

Deposits from customers
Deposits from customers includes a deposit by the LLP subsidiary relating to the legal transfer of loans and advances on issue of the Bank's covered bond. The deposit is fair valued to eliminate an accounting mismatch of the swap derivative as discussed above.

Revaluation of the £2.0bn mortgage coverpool from book to fair value is based on assumed timing of future mortgage capital and revenue receipts, discounted to present value using a credit adjusted discount rate.

The amortisation profile is as per the swaps valuation methodology, assuming some annual prepayment, but is extended beyond any bond maturity, until all the mortgages themselves mature, which is circa 25 years. Similarly, the revenue receipts are calculated as per the swap valuation methodology, but extended until all the mortgages mature. For fixed rate mortgages revenue receipts are based on fixed customer rates within the assumed amortisation profile. For tracker, SVR and discount products revenue receipts are assumed to be based on forward LIBOR rates plus the product margins. Fixed and tracker mortgages are assumed to revert to SVR at end of any offer period. All mortgages in the covered bond pool were originated pre 31 December 2007.

Primary financial instruments used by the Bank
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. Customer loans include retail mortgages, corporate loans, credit cards, unsecured retail lending and overdrafts. Customer deposits include retail and corporate current and saving accounts. 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
Debt securities include structured investments and credit trading funds. Further details are provided in critical judgements on page 85. Debt securities also underpin the Bank's liquidity requirements and generate incremental net interest and trading income.

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.

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 a financial instrument that derives its value from an underlying rate or price such as interest rates, exchange rates and other market prices. Derivatives are an efficient means of managing market risk and limiting counterparty exposure. The Bank uses them mainly for hedging purposes and to meet the needs of customers.

The most frequently used derivative contracts are interest rate swaps, exchange traded futures and options, caps and floors, 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.

Operational risk

Operational risk is defined within CFS as the risk of loss resulting from inadequate or failed internal processes, people and systems or external events. This encompasses the effectiveness of risk management techniques and controls to minimise these losses.

Operational risk framework

Operational risks are identified, managed and mitigated through ongoing risk management practices including risk assessments; formal internal control procedures; training; segregation of duties; delegated authorities; and contingency planning. Operational risks are formally reviewed on a regular basis. Significant operational risks are regularly reported to Executive Directors, a management Operational Risk Committee, and the Audit and Regulatory Compliance Committee (a formal Board sub-committee). These meet regularly to monitor the suitability of the risk management framework and management of significant risks within CFS. Capital requirements in relation to operational risk are monitored by the Risk Management Committee.

2008 has seen continued refinement and embedding of the framework including development of an operational risk appetite statement, and reporting enhancements. The framework is subject to regular Internal Audit review in line with CFS' rolling risk-based audit plan.

Responsibilities

Whilst the Board is ultimately responsible for operational risks across the Bank and the wider CFS organisation, this is delegated to the Chief Executive and Executive Directors within CFS who are responsible for controlling the operational risks in their direct areas of accountability and for compliance with CFS policies.

Each Executive has a nominated Divisional Risk Coordinator who is a member of the Operational Risk Committee and is responsible for ensuring the consistent application of the operational risk framework within their division. Divisional Risk Coordinators are supported from within their business division.

The central operational risk team facilitate the consistent identification, management and reporting of operational risks across CFS in line with regulatory and business requirements; support development and testing of business continuity arrangements for the business; and manage the CFS corporate insurance programme.

Risk themes

CFS categorises operational risk into a number of distinct themes for internal management, monitoring and reporting. Key operational risk themes managed by CFS include:

Financial crime

This relates to the effectiveness of controls to minimise financial losses arising from the fraudulent activities of employees, customers and third parties. Specific risks arise from external fraud, including but not limited to computer fraud (computer viruses, key logging tools, Trojan attacks, phishing), anti money laundering (including, but not limited to, failure to comply with FSA money laundering regulations and to prevent organised crime) and internal fraud.

Data security and confidentiality

CFS has introduced a new theme during 2008 in respect of the potential loss or theft of confidential customer information. This enables the organisation to manage and monitor exposures in this area as a specific theme, recognising the increasing concerns of customers, regulatory authorities and the media in this area, as well as reflecting CFS' risk management culture.

Compliance (with regulatory and legal requirements)

As a regulated business, CFS places great emphasis on maintaining compliance with our regulatory and legal obligations by:

- Regulatory – supporting CFS' business objectives through the provision of advice, and the recommendation of solutions where appropriate, in respect of the regulatory implications of business developments, and assisting the business in assessing and addressing new and enhanced regulatory expectations. This is supported by appropriate and effective monitoring, aimed at influencing the business to mitigate or eliminate regulatory risk and demonstrate that we are meeting our regulatory obligations.
- Legal – seeking to pro-actively manage legal issues in relation to commercial, contractual, employment and litigation activities.

Employee practices/workplace safety
It is acknowledged that our people are a key asset. The financial services sector as an industry is reliant on its people and the skills, knowledge and experience that they provide. The risk of failure to maintain employee relations, or provide a safe environment in line with legislative requirements and with the ethical, diversity and discrimination rules is managed with support from our Human Resources division.

Property & facilities
The risk of unforeseen operational disruption caused through the denial of access to major occupancies or other interruptions to business operations is managed through our business continuity framework and corporate insurance programme.

Customer service
As a financial services business, providing fair and high-quality customer service is a must. Controls that could prevent such risks occurring are regularly assessed and monitored. These include customer service levels, getting things right first time, availability of customer facing systems, together with trained and skilled resource to service customer demand.

Supplier
CFS looks to source cost-effective and quality services, both internal and external to the Co-operative Group. Given the reliance on our business partners who provide services and products, a major or prolonged disruption to the supply of their services and products would impact on CFS. Risks are monitored relating to the effectiveness of contracts and relationship management to ensure that CFS' expected performance levels are achieved.

Major IT systems/major payments systems failure
Financial service providers have a heavy reliance on the availability and performance of underlying systems and applications, and the processes and frameworks which underpin these. Consequently the effectiveness of controls over the IT systems and infrastructure supporting IT processes and controls, major payment systems and clearing and business processes are monitored on a regular basis.

Change management
CFS continues to invest in major change programmes in our journey to become the UK's most admired financial services business, through developing and improving our products, systems and processes.

To manage delivery of these change programmes, manage risks, prioritise resources and realise benefits CFS has developed and implemented a Change Management Framework. This is regularly reviewed to maintain its effectiveness.

Basel II is an internationally agreed framework for banking regulation and capital management. Following the FSA approval of the Bank's Waiver application in December 2007, the Bank has been operating fully on an internal rating basis (IRB) since the start of 2008. The Bank's Internal Capital Adequacy Assessment Process (ICAAP) is being regularly updated following the granting of the Individual Capital Guidance (ICG) from the FSA in early 2008. The Pillar 3 disclosures for the Co-operative Bank Group based on year-end 10 January 2009 will be available on the CFS website (www.cfs.co.uk).

Principal risk
In addition to the significant risks covered above, the following risks are also reported in the new CFS risk management framework:

- Group wide risks, to include pensions, reputational and group risk; and
- Business risk.

Pensions risk: the risk of the firm being unable to meet Pension Fund Commitments.

Pensions risks are identified at the Co-operative Group level, with the impact of any potential changes to contribution assessed under the Bank Risk Management Framework.

Reputational risk: failure to proactively develop, protect and optimise the value of the brands of the CFS group of companies through inappropriate strategic decisions, poor business performance, or operational failure.

Reputational risks are identified at the Bank entity level. As part of the assessment of this risk, we consider the impact of other CFS entities and Co-operative Group entities to the Bank.

Contagion risk: risks originating from elsewhere in the Group impacting upon the Bank.

Business risk: arises from changes to the Bank's business, specifically the risk of not being able to carry out the Bank's business plan and desired strategy, including the ability to provide suitable products and services to customers. In a narrow sense, business risk is the risk the Bank suffers losses because income falls or is volatile relative to the fixed cost base. However, in a broader sense, it is the Bank's exposure to a wide range of macro-economic, geopolitical, industry, regulatory and other external risks.

Regulation risk

The Bank is subject to laws and regulations which are subject to change, with its main regulator being the FSA. Regulatory intervention is an ongoing feature of UK banking and changes could affect the profitability of our business. A key risk has arisen from the ongoing investigation into bank charges resulting in a test case to resolve legal uncertainties concerning the fairness and lawfulness of unauthorised overdraft charges. Full details of test case process are set out in the Contingent liabilities and commitments note 31 on page 107. A definitive outcome of the test case process is unlikely to be known for the foreseeable future.

A further court hearing took place in July 2008 to assess whether historic terms and conditions are capable of being penalties. No judgement has been given to date.

A range of outcomes is possible from the test case and any appeals, some of which could have a significant impact on the Group. Therefore it is not considered appropriate at this stage, to reliably estimate the financial impact on the Group.

The most immediate and significant regulatory issue facing our business at present is the Competition Commission investigation of payment protection insurance The investigation has now concluded. The Bank is currently assessing the investigations findings. Following a request made by the FSA to all institutions to voluntarily withdraw from the single premium PPI market by 31 January 2009, the Bank stopped selling its single premium PPI on the 4 January 2009.

All amounts are stated in £m unless otherwise indicated

Capital resources

The Group's policy is to maintain a strong base so as to maintain investor, creditor and market confidence and to sustain future development of the business. The Group's policy is to be more prudent than industry norms by having a higher proportion of core tier 1 as the Group is not able to raise equity externally. However, the Group still recognises the need to maintain a balance between the potential higher returns that might be achieved with greater gearing, and the advantages and security afforded by a sound capital position.

On 26 January 2009, the Bank issued £120 million of share capital to its parent company, Co-operative Financial Services Limited to reinforce its capital strength and give the bank eligibility of the Government's Credit Guarantee Scheme.

Our submissions to the FSA in the year have shown that the Group and its individually regulated operations have complied with all externally imposed capital requirements throughout the period.

There have been no material changes in the Group's management of capital during the period.

	2008	2007
Core tier one capital		
Permanent share capital	**55.0**	55.0
Retained earnings	**627.6**	633.7
Minority Interest	**26.8**	25.0
Interim profits/(losses)	**12.4**	(6.1)
Share premium account	**8.8**	8.8
Total core tier one capital	**730.6**	716.4
Perpetual non cumulative preference shares	**60.0**	60.0
Total tier one capital before regulatory deductions	**790.6**	776.4
Tier two capital		
Revaluation reserves	**5.6**	–
Long term subordinated debt	**298.4**	298.1
Total tier two capital before deductions	**304.0**	298.1

The Group's regulatory capital is analysed with two tiers:

Tier one capital

Tier one capital includes share capital, retained earnings, and perpetual non cumulative preference shares. The preference shares carry the right to a fixed non cumulative preferential dividend at a rate of 9.25%, payable 31 May and 30 November. Retained earnings exclude gains or losses on cash flow hedges and available for sale assets.

Tier two capital

Revaluation reserves relating to net gains on equity held in the available for sale financial assets category are included in tier two capital.

The tier two capital includes two subordinated debt issues, £150m Step Up Callable Subordinated Notes 2019 and £150m Callable Subordinated Notes 2021 fixed rate until 2016, then moving to floating rate. The rights of repayment to the holders of subordinated debt are subordinated to the claims of depositors and other creditors of the Bank. More information on these can be found in note 23.

During the previous reporting period the Bank moved from reporting on a Basel I basis to a Basel II basis using the IRB approach. The Group obtained FSA permission to report on this basis in December 2007. This change impacts on the regulatory capital deductions from Tier 1 and Tier 2 capital for certain risks, particularly credit risk where deductions are now calculated with reference to the expected loss on the Group's assets under various scenarios.

The capital ratios reported in the business and financial review are based on the pillar I capital requirement.

Capital allocation

The allocation of capital between specific operations and activities is driven by optimisation of the return achieved on the capital allocated, and is based upon the regulatory capital. Capital allocation is undertaken independently of those responsible for capital management, and is reviewed by ALCO. Each new product must earn at least the Group's minimum target return on equity.

The Bank makes estimates and assumptions that effect the reported assets and liabilities. Critical estimates and judgements are continually assessed and reviewed, and are based on historical experience and reasonable expectations of future events.

Financial asset and liability classification

The Bank's accounting policies provide scope for assets and liabilities designated at inception into different accounting categories in certain circumstances as outlined on page 52 and defined as follows:

- In classifying financial assets and liabilities as 'trading', the Bank has determined that it meets the description of trading assets for those assets and liabilities it acquires or incurs principally for the purpose of selling or repurchasing in the near term, or holds as part of a portfolio that is managed together for short term profit or position taking as set out in accounting policy (c) iii)).
- In designating financial assets or liabilities at fair value through profit or loss, the Bank has determined that it has met one of the criteria for this designation as set out in accounting policy (c) iii)).
- In classifying assets as Loans and Receivables at amortised cost, the Bank has determined it meets the description as set out in accounting policy (c(i)).

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

Investment valuation and impairment

Background

The Bank's investment portfolio primarily comprises Bank and Building Certificates of Deposit (CDs), Floating Rate Notes (FRNs) and government issued securities. Additionally, the Bank has a small portfolio of 3 structured investments (SIVs) and 1 Credit Trading vehicle (CTV) investment. Further analysis is provided below and on page 95.

Valuation approach

The accounting treatment for these assets is primarily available for sale which means that they are fair valued in the balance sheet with movements passing through reserves, unless the assets are deemed to be impaired which results in movements being recognised in the income statement.

The reduction in liquidity in wholesale markets or 'credit crunch' has lead to a loss of active markets and availability of traded prices for particular assets. As explained on page 94, these assets have been reclassified as loans and receivables and are held in the balance sheet at amortised cost less any associated impairment.

Except for those assets reclassified to loans and receivables the Bank's CDs, FRNs and Government Issued Securities are valued daily based up on an observable market price feed data, with all non moving valuations validated against an alternative price source. No significant assumptions are required.

The Bank has fully provided against 2 of its 3 SIVs. The other SIV, which has been impaired by 80%, is valued on a discounted cash flow basis.

The CTV was reclassified to Loans & Receivables on 27 July 2008 as a result of amendments to IAS 39 and is accounted for on an amortised cost basis.

The valuations of the Bank's remaining SIV is to some extent driven by assumptions and is sensitive to changes in this assumptions.

The valuation of structured investment 1 is primarily affected by assumptions as to expected default rates within the underlying portfolios and variation in funding margins. The impact of changing the funding margin assumption by 15bp would be a decrease in value of £0.2m. The impact of changing the funding margin assumption by 15bp and applying stressed defaults scenario (calculated at 1000% of idealised defaults) would be a decrease in value of £1.2m.

Impairment approach

Impairment has been assessed by:

- Is there evidence that a loss event has occurred; and
- Does the loss event have a negative impact on future cash flows.

Each of the Bank's structured investments and credit trading vehicle meet these criteria and therefore an impairment provision has been made. These assessments have particularly given consideration to evidence of any significant financial difficulty of the issuer or measurable decrease in the estimated cash flows from the investments. The impairment of the CTV in particular has given consideration to future cash flows and expected levels of defaults.

Further information on the Bank's accounting policy for impairment is given on page 53.

All amounts are stated in £m unless otherwise indicated

At 10 January 2009, The Bank holds 3 Structured Investments and 1 Credit Trading Vehicle as shown below:

	Investment (currency)	Investment (sterling)	Impairment Provision held (sterling)	Balance sheet value
Structured investment 1	£20.0	20.0	16.0	2.7
Structured investment 2	US$20.0	13.1	13.1	–
	€20.0	17.8	17.8	–
Structured investment 3	US$35.0	22.9	22.9	–
Credit Trading vehicle	£25.0	25.0	12.5	12.5
Total		**98.8**	**82.3**	**15.2**

The Bank owns less than 2.5% of the capital held of each of these investments and therefore they are not consolidated.

Impairment on loans and advances

The loan portfolios are reviewed on a continuous basis to assess impairment. In determining whether an impairment provision should be recorded, judgements are made as to whether there is objective evidence that a financial asset or portfolio of financial assets is impaired as a result of loss events that occurred after recognition of the asset and 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 impairment debt.

The provision rates reflect the likelihood that the debt in that category/age will be written off or charged off at some point in the future. The rates are based on historical experience and current trends, 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 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.

Effective Interest Rate

IAS 39 requires interest income to be 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. On applying this approach to the mortgage portfolio, judgements are made in relation to estimating the average life of that portfolio. These judgements are made based on specific factors including product terms and historical repayment data. The estimates are updated in each reporting period to reflect actual performance. A key judgement area is the average life of the mortgage portfolio. A change in the average life by one year would have an increase of 0.2% in gross interest income.

Financial Services Compensation Scheme levy

The Financial Services Compensation Scheme provides compensation to customers of financial institutions in the event that an institution is unlikely, or is likely to be unable, to pay claims against it. As a result of a number of institutions failures during the year the FSCS has borrowed £19.7 billion on an interest only basis until September 2011 from HM Treasury in order to meet its obligations to the depositors. These borrowings are anticipated to be repaid wholly or substantially from the realisation of the assets of the failed institutions. The FSCS raises annual levies from the banking industry in order to meet its management expenses and compensation costs. The annual levies are based upon the individual institutions proportion of protected deposits of the total market protected deposits at 31 December of each year. The Group has provided for £10.5m for its share of levies that will be raised by the FSCS including the interest on the loan from the HM Treasury in respect of the levy years to 31 March 2010. The provision includes estimates for the interest FSCS will pay on the loan and of the Group's market participation in the relevant periods.

At the date of these financial statements, it is not possible to estimate whether there will be ultimately additional levies on the industry, the level of the Groups market participation or other factors that may affect amounts or the timing of amounts that may ultimately become payable, nor the effect that such levies may have upon operating results in any particular periods.

All amounts are stated in £m unless otherwise indicated

1. Segmental analysis

The Group's primary basis of segmentation is by business activity. Activities have been segmented between Retail banking, Corporate 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:

- **Retail** – customer focused products and services for individuals, sole traders and small partnerships. It includes mortgages, credit cards, consumer loans, small business 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.

2008	Retail	Corporate	Wholesale	Total
External gross revenue	558.7	324.8	177.4	1,060.9
External net revenue	313.7	226.1	29.6	569.4
Internal net revenue	77.6	(74.1)	(3.5)	–
Operating income	391.3	152.0	26.1	569.4
Operating costs	(265.5)	(60.4)	(10.4)	(336.3)
Impairment losses on loans and advances	(84.8)	(12.0)	–	(96.8)
Impairment losses on investments	–	–	(50.7)	(50.7)
Operating profit	41.0	79.6	(35.0)	85.6
Profit based payments to members of the Co-operative Group				(4.7)
Financial Services Compensation Scheme levy				(10.5)
Significant Items				(47.1)
Profit before taxation				23.3
Income tax expense				(6.0)
Profit for the year				17.3

2008 Other information	Retail	Corporate	Wholesale	Total
Segmental assets	5,700.2	4,361.4	4,566.1	14,627.7
Unallocated assets				336.4
Consolidated assets				14,964.1
Segmental liabilities	7,936.0	3,206.4	2,524.6	13,667.0
Unallocated liabilities				516.4
Consolidated liabilities				14,183.4
Capital expenditure	–	0.3	–	0.3
Depreciation and amortisation	16.5	3.4	0.2	20.1

1. Segmental analysis (continued)

2007	Retail	Corporate	Wholesale	Total
External gross revenue	548.3	282.9	190.8	1,022.0
External net revenue	313.2	197.2	13.1	523.5
Internal net revenue	85.8	(69.4)	(16.4)	–
Operating income	399.0	127.8	(3.3)	523.5
Operating costs	(273.1)	(57.9)	(8.3)	(339.3)
Impairment losses on loans and advances	(87.9)	(14.1)	–	(102.0)
Impairment losses on investments	–	–	(31.8)	(31.8)
Operating profit	38.0	55.8	(43.4)	50.4
Profit based payments to members of the Co-operative Group				(1.3)
Significant Items				(38.0)
Profit before taxation				11.1
Income tax expense				(5.2)
Profit for the year				5.9

2007	Retail	Corporate	Wholesale	Total
Other information				
Segmental assets	5,105.6	3,543.4	4,083.1	12,732.1
Unallocated assets				354.8
Consolidated assets				13,086.9
Segmental liabilities	6,757.7	2,624.8	2,466.4	11,848.9
Unallocated liabilities				521.1
Consolidated liabilities				12,370.0
Capital expenditure	10.6	3.7	0.4	14.7
Depreciation and amortisation	18.9	3.5	0.3	22.7
Impairment gains/(losses) recognised in equity				

The Group's activities are in the UK.

2. Profit before taxation

Profit before taxation is stated after:	**2008 £'000**	2007 £'000
Audit of these financial statements	**207**	192
Other services		
Amounts receivable by auditors and their associates in respect of:		
Audit of financial statements of subsidiaries pursuant to legislation	**109**	106
Other services pursuant to such legislation	**15**	15
Other services relating to taxation	**9**	–
Services relating to litigation	**4**	–
Services relating to information technology	**137**	–
Services relating recruitment and remuneration	**3**	–
All other services	**49**	143
Total	**533**	456

Amounts paid to the Company's auditor in respect of services to the Company, other than the audit of the Company's financial statements, have not been disclosed as the information is required instead to be disclosed on a consolidated basis.

3. Directors' emoluments

	2008 £'000	2007 £'000
Non-Executive Directors	–	–
Executive Directors	1,487	1,188
Compensation for loss of office	249	174
	1,736	1,362

Retirement benefits are accruing to two Directors (2007: nil) under defined benefit schemes.

All Non-Executive Directors are appointed and their Directors' fees are determined and paid by the Co-operative Group and therefore no amounts are shown above (2007: nil). Further details of Directors' emoluments are included in the remuneration report on pages 37 to 42.

4. Net interest income

	2008	2007
Interest and similar income		
Income on items not at fair value through profit or loss	832.2	802.2
Income on items at fair value through profit or loss	2.3	2.2
Fair value movements	(4.3)	(4.4)
	830.2	800.0

Interest income accrued on impaired financial assets during the period was £15.6m (2007: £14.6m), interest due to unwinding of discount on impairment provisions relating to impaired financial assets amounted to £3.8m (2007: £4.3m).

Interest expense and similar charges
Interest payable of £455.9m (2007: £465.2m) relates to liabilities not at fair value through profit or loss.

5. Net fee and commission income

	2008	2007
Fee and commission income on items not at fair value through profit or loss	215.8	216.0
Fee and commission income on items at fair value through profit or loss	–	0.1
Fee and commission income on trust or fiduciary activities that result from holding or investing in assets on behalf of others	0.7	0.4
Total fee and commission income	216.5	216.5
Fee and commission expense on items not at fair value through profit or loss	35.6	33.1
Fee and commission expense on items at fair value through profit or loss	–	0.2
Total fee and commission expense	35.6	33.3

6. Net trading income

	2008	2007
Foreign exchange	5.3	5.2
Interest rate instruments	(0.4)	0.3
	4.9	5.5

'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 transacting in government securities, moneymarket instruments, interest rate and currency swaps, options and other derivatives.

All amounts are stated in £m unless otherwise indicated

7. Operating expenses

	Before significant items 2008	Significant items 2008	After significant items 2008	Before significant items 2007	Significant items 2007	After significant items 2007
Staff costs (Note 8)	**151.1**	**14.0**	**165.1**	145.3	18.2	163.5
Administrative expenses	**148.5**	**33.1**	**181.6**	153.6	19.8	173.4
Depreciation (Note 18)	**17.2**	**–**	**17.2**	19.1	–	19.1
Loss on sale of property, plant and equipment	**2.4**	**–**	**2.4**	7.4	–	7.4
Software costs (Note 17)	**2.9**	**–**	**2.9**	3.6	–	3.6
Operating lease rentals	**14.2**	**–**	**14.2**	10.3	–	10.3
	336.3	**47.1**	**383.4**	339.3	38.0	377.3

8. Staff costs

	Before significant items 2008	Significant items 2008	After significant items 2008	Before significant items 2007	Significant items 2007	After significant items 2007
Wages and salaries	**108.2**	**4.2**	**112.4**	111.1	2.5	113.6
Social security costs	**8.9**	**0.3**	**9.2**	9.2	0.2	9.4
Pension costs – defined benefit plans	**0.2**	**–**	**0.2**	0.3	–	0.3
– defined contribution plans	**11.8**	**0.4**	**12.2**	11.9	0.3	12.2
Other staff costs	**22.0**	**9.1**	**31.1**	12.8	15.2	28.0
	151.1	**14.0**	**165.1**	145.3	18.2	163.5

Staff costs in relation to Bank only are £147.2m pre-significant items, £161.2m post significant items (2007: £141.7m pre-significant items, £159.8m post significant items).

Average number of employees

The average number of persons working for the Group during the year was made up as follows:

	No of employees 2008	No of employees 2007
Full time	**3,035**	3,305
Part time	**955**	976
	3,990	4,281

The average number of persons working for the Bank during the year was made up as follows:

	No of employees 2008	No of employees 2007
Full time	**2,957**	3,233
Part time	**943**	965
	3,900	4,198

Employee activities are undertaken across the CFS Group and the figures above reflect the Bank's share of these services.

9. Income tax expense

	Before significant items 2008	Significant items 2008	After significant items 2008	Before significant items 2007	Significant items 2007	After significant items 2007
Current tax – current year	**21.9**	**(13.4)**	**8.5**	18.6	(11.4)	7.2
Current tax – prior year	**–**	**–**	**–**	0.3	–	0.3
Deferred tax (Note 26)	**(2.5)**	**–**	**(2.5)**	(2.3)	–	(2.3)
	19.4	**(13.4)**	**6.0**	16.6	(11.4)	5.2

9. Income tax expense (continued)

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

	2008	2007
Profit before tax	**23.3**	11.1
Tax calculated at a tax rate of 28.44% (2007: 30%)	**6.6**	3.3
Effect of:		
Preference share interest not deductible for tax purposes	**1.6**	1.7
Expenses not deductible for tax purposes	**0.1**	0.1
Depreciation of expenditure not qualifying for capital allowances	**0.3**	0.5
Non taxable income	**(2.7)**	
Adjustments to tax charge in respect of prior periods	**0.1**	–
Tax rate change on deferred tax to 28%	**–**	(0.4)
	6.0	5.2

Tax rate applied is calculated based on the effective rate of tax as a result of the change in tax rate from 30% to 28% as from April 2008.

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

£12.4m profit (pre-significant items: £46.1m profit) (2007: £1.1m loss, pre-significant items: £25.5m profit) 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.

11. 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.

	Before significant items 2008	**Significant items 2008**	**After significant items 2008**	Before significant items 2007	Significant items 2007	After significant items 2007
Profit attributable to equity holders of the Bank	**47.2**	**(33.7)**	**13.5**	29.8	(26.6)	3.2
Weighted average number of ordinary shares in issue (millions)	**1,100.0**	**1,100.0**	**1,100.0**	1,100.0	1,100.0	1,100.0
Basic earnings per share (expressed in pence per share)	**4.29**	**(3.06)**	**1.23**	2.71	(2.42)	0.29

12. Loans and advances to banks

	Group		**Bank**	
	2008	2007	**2008**	2007
Items in course of collection from other banks	**148.5**	141.3	**148.4**	141.0
Placements with other banks	**1,441.2**	1,062.7	**1,452.1**	1,070.2
Included in cash equivalents	**1,589.7**	1,204.0	**1,600.5**	1,211.2
Other loans and advances to banks	**297.0**	–	**297.0**	–
	1,886.7	1,204.0	**1,897.5**	1,211.2
Of which:				
Variable rate	**399.9**	268.1	**399.9**	268.1
Fixed rate	**1,486.8**	935.9	**1,497.6**	943.1

Mandatory reserve deposits of £9.9m (2007: £11.3m) are not available for use in the Group and Bank's day-to-day operations, are non-interest bearing and are included in cash equivalents. Group and Bank collateral of £328.7m (2007: £53.9m) held under reverse repo agreements can be sold or repledged without default. At the balance sheet date £nil (2007: £nil) was resold or repledged. These transactions are conducted under standard repo agreement terms.

All amounts are stated in £m unless otherwise indicated

13. Loans and advances to customers

	Group 2008	Group 2007	Bank 2008	Bank 2007
Gross loans and advances	**10,494.2**	9,169.7	**11,356.8**	9,075.1
Less: allowance for losses on loans and advances	**(187.9)**	(160.7)	**(187.0)**	(160.7)
	10,306.3	9,009.0	**11,169.8**	8,914.4
Of which:				
Variable rate	**5,210.2**	4,475.9	**6,131.2**	4,430.1
Fixed rate	**5,096.1**	4,533.1	**5,038.6**	4,484.3

Loans and advances to customers include £2.0bn (2007: £nil) for both Group and Bank which have been legally transferred from the Bank to The Covered Bond LLP, a limited liability partnership which is consolidated by the Bank Group. The loans are retained on the Bank's balance sheet as the Bank substantially retains the risks and rewards relating to the loans. A liability is recognised within customer accounts on the Bank balance sheet to reflect the accounting transaction. The loans secure £1.0bn (2007: £nil) of covered bonds issued by the Bank in 2008. The covered bonds were immediately repurchased by the Bank and therefore no liability is recognised on balance sheet.

The mortgages transferred have, subsequent to the balance sheet date, been utilised as security for £700m of UK Treasury Bills drawn down from the Bank of England Special Liquidity Scheme.

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 2008	Group 2007	Bank 2008	Bank 2007
Property and construction	**1,687.8**	1,326.0	**1,658.9**	1,309.5
Retail distribution and services	**972.5**	753.9	**884.3**	695.5
Business and other services	**2,015.5**	1,888.1	**2,995.2**	1,868.4
Personal – unsecured	**1,727.7**	1,890.9	**1,727.7**	1,890.9
Personal – secured	**4,090.7**	3,310.8	**4,090.7**	3,310.8
	10,494.2	9,169.7	**11,356.8**	9,075.1

Allowance for losses on loans and advances

Movement in allowance for losses on loans and advances:

	Individual mortgage 2008	Individual corporate 2008	Collective 2008	Total 2008	Individual mortgage 2007	Individual corporate 2007	Collective 2007	Total 2007
Group								
At the beginning of the year	**0.3**	**35.3**	**125.1**	**160.7**	0.6	26.9	127.8	155.3
Charge against profits	**1.5**	**11.2**	**84.1**	**96.8**	0.3	13.6	88.1	102.0
Amounts written off	**(0.3)**	**(1.6)**	**(65.5)**	**(67.4)**	(0.6)	(4.4)	(87.9)	(92.9)
Recoveries	**–**	**0.2**	**–**	**0.2**	–	0.1	–	0.1
Unwind of discount of allowance	**–**	**(0.9)**	**(2.9)**	**(3.8)**	–	(1.4)	(2.9)	(4.3)
Interest charged on impaired loans	**–**	**1.4**	**–**	**1.4**	–	0.5	–	0.5
At the end of the year	**1.5**	**45.6**	**140.8**	**187.9**	0.3	35.3	125.1	160.7

	Individual mortgage 2008	Individual corporate 2008	Collective 2008	Total 2008	Individual mortgage 2007	Individual corporate 2007	Collective 2007	Total 2007
Bank								
At the beginning of the year	**0.3**	**35.3**	**125.1**	**160.7**	0.6	26.9	127.8	155.3
Charge against profits	**1.5**	**10.3**	**84.1**	**95.9**	0.3	13.6	88.1	102.0
Amounts written off	**(0.3)**	**(1.6)**	**(65.5)**	**(67.4)**	(0.6)	(4.4)	(87.9)	(92.9)
Recoveries	**–**	**0.2**	**–**	**0.2**	–	0.1	–	0.1
Unwind of discount of allowance	**–**	**(0.9)**	**(2.9)**	**(3.8)**	–	(1.4)	(2.9)	(4.3)
Interest charged on impaired loans	**–**	**1.4**	**–**	**1.4**	–	0.5	–	0.5
At the end of the year	**1.5**	**44.7**	**140.8**	**187.0**	0.3	35.3	125.1	160.7

All amounts are stated in £m unless otherwise indicated

13. Loans and advances to customers (continued)

Group and Bank loans and advances to customers include £35.8m (2007: £29.1m) of financial assets at fair value through profit or loss designated at initial recognition to eliminate or significantly reduce a measurement or recognition inconsistency. Of these, £31.2m (2007: £29.1m) is secured by real estate collateral.

Loans and advances to customers include finance lease receivables, as follows:

	Group		Bank	
	2008	2007	**2008**	2007
Gross investment in finance leases, receivable:				
No later than one year	**36.8**	47.2	**33.7**	40.8
Later than one year and no later than five years	**96.0**	101.4	**73.4**	77.9
Later than five years	**69.1**	72.2	**34.1**	32.1
	201.9	220.8	**141.2**	150.8
Unearned future finance income on finance leases	**(40.5)**	(47.2)	**(19.3)**	(22.6)
Net investment in finance leases	**161.4**	173.6	**121.9**	128.2

The net investment in finance leases may be analysed as follows:

	Group		Bank	
	2008	2007	**2008**	2007
No later than one year	**27.9**	35.6	**27.9**	32.7
Later than one year and no later than five years	**74.8**	77.7	**62.6**	65.5
Later than five years	**58.7**	60.3	**31.4**	30.0
	161.4	173.6	**121.9**	128.2

There are no unguaranteed residual values for any of the finance leases.
The Group enters into finance lease and hire purchase arrangements with customers in a wide range of sectors including transport, retail and utilities.
The accumulated allowance for uncollectible minimum lease payments receivable is £5.9m (2007: £5.0m).

14. Debt securities

	Group		Bank	
	2008	2007	**2008**	2007
Gross debt securities:				
Listed	**751.1**	843.3	**751.1**	843.3
Unlisted	**1,572.9**	1,619.4	**1,151.4**	1,174.2
	2,324.0	2,462.7	**1,902.5**	2,017.5
Less: impairment for losses on debt securities	**(92.3)**	(31.8)	**(92.3)**	(31.8)
	2,231.7	2,430.9	**1,810.2**	1,985.7
Included in cash equivalents	**579.5**	693.3	**579.5**	693.3

Listed debt securities at a fair value of £nil (2007: £nil) had been pledged to third parties in sale and repurchase agreements.

Debt securities by classification:	**Gross 2008**	**Impairment loss 2008**	**Net 2008**	Gross 2007	Impairment loss 2007	Net 2007
Group						
Fair value through profit or loss	**–**	**–**	**–**	6.9	–	6.9
Available for sale	**2,178.1**	**(69.8)**	**2,108.3**	2,455.8	(31.8)	2,424.0
Loans and receivables at amortised cost	**145.9**	**(22.5)**	**123.4**	–	–	–
	2,324.0	**(92.3)**	**2,231.7**	2,462.7	(31.8)	2,430.9

All amounts are stated in £m unless otherwise indicated

14. Debt securities (continued)

Debt securities by classification:	**Gross 2008**	**Impairment loss 2008**	**Net 2008**	Gross 2007	Impairment loss 2007	Net 2007
Bank						
Fair value through profit or loss	**–**	**–**	**–**	6.9	–	6.9
Available for sale	**1,756.6**	**(69.8)**	**1,686.8**	2,010.6	(31.8)	1,978.8
Loans and receivables at amortised cost	**145.9**	**(22.5)**	**123.4**	–	–	–
	1,902.5	**(92.3)**	**1,810.2**	2,017.5	(31.8)	1,985.7

Reclassification of available for sale assets
Pursuant to the amendments to IAS 39 and IFRS 7 (described on page 52), the Bank reclassified specific available for sale investment securities to loans and receivables at amortised cost. The Bank identified particular assets that would have met the definition of loans and receivables (if they had not been designated as available for sale) for which at 27 July 2008 it considered it had the intention and ability to hold them for the foreseeable future or until maturity due to the market in such an instrument considered to be inactive.

As per the amendment to IAS 39, the reclassifications were made with effect from 27 July 2008 at fair value at that date. The table below sets out the carrying value and fair values for both Group and Bank at the date of reclassification and the balance sheet date:

	27 July 2008		**10 January 2009**	
	Carrying value	**Fair value**	**Carrying value**	**Fair value**
Available for sale financial assets transferred to loans and receivables	131.9	131.9	123.4	112.3

Fair value equated to carrying value at the date transfer. The fair value was based on quoted market prices.

The table below sets out the amounts actually recognised during the 2008 financial year in respect of the reclassified instruments for both Group and Bank.

	Profit or loss Period before reclassification 28 weeks to 27 July 2008	**Profit or loss Period after reclassification 24 weeks to 10 January 2009**	**Profit or loss 52 weeks to 10 January 2009**	**Equity Period before reclassification 28 weeks to 27 July 2008**	**Equity Period after reclassification 24 weeks to 10 January 2009**	**Equity 52 weeks to 10 January 2009**
Interest income	3.7	3.4	**7.1**	–	–	**–**
Net impairment loss	–	(22.5)	**(22.5)**	–	3.5	**3.5**
Net change in fair value	–	–	**–**	(8.1)	1.5	**(6.6)**
	3.7	**(19.1)**	**(15.4)**	**(8.1)**	**5.0**	**(3.1)**

The table below sets out the amounts that would have been recognised for both Group and Bank in the period following the reclassification during 2008 if the reclassification had not been made:

	Profit or loss	**Equity**
Interest income	3.4	–
Net impairment loss	(22.5)	12.5
Net change in fair value	–	(28.6)
	(19.1)	**(16.1)**

At 27 July 2008, the effective interest rates on available for sale assets reclassified to loans and receivables at amortised cost ranged from 8 percent to 12 percent with expected recoverable cash flows as at 10 January 2009 of £142.5m.

All amounts are stated in £m unless otherwise indicated

14. Debt securities (continued)

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

	2008	2007
Derecognition of available for sale assets	**3.1**	(0.3)

The movement in debt securities is summarised as follows:

	Group		Bank	
	2008	2007	**2008**	2007
At the beginning of the year	**2,430.9**	2,753.1	**1,985.7**	2,369.6
Acquisitions	**13,961.5**	10,806.7	**12,134.9**	9,889.7
Disposals and maturities	**(14,155.2)**	(11,108.9)	**(12,303.5)**	(10,253.0)
Exchange adjustments	**73.6**	19.6	**73.6**	19.6
Amortisation	**0.2**	1.0	**0.2**	1.0
Fair value movements – through equity	**(23.7)**	(3.2)	**(25.1)**	(3.8)
Fair value movements – through profit or loss	**(4.9)**	(5.6)	**(4.9)**	(5.6)
Impairment losses	**(50.7)**	(31.8)	**(50.7)**	(31.8)
At the end of the year	**2,231.7**	2,430.9	**1,810.2**	1,985.7

Impairment analysis of debt securities

	Group		Bank	
	2008	2007	**2008**	2007
At the beginning of the year	**31.8**	–	**31.8**	–
Allowance for impairment losses on debt securities	**19.0**	–	**19.0**	–
Impairment losses recycled through equity reserves	**31.7**	31.8	**31.7**	31.8
Charge for the year	**50.7**	31.8	**50.7**	31.8
Foreign exchange adjustments	**9.8**	–	**9.8**	–
At the end of the year	**92.3**	31.8	**92.3**	31.8

Foreign exchange adjustments are reflected within net trading income consistent with exchange adjustments on currency instruments.

	Group		Bank	
	2008	2007	**2008**	2007
Analysis of debt securities by issuer				
Investment securities issued by public bodies:				
Government securities	**12.6**	91.6	**12.6**	91.6
Other public sector securities	**10.5**	1.0	**10.5**	1.0
	23.1	92.6	**23.1**	92.6
Investment securities issued by other issuers:				
Bank and building society certificates of deposits	**1,466.9**	1,533.5	**1,045.4**	1,088.3
Other debt securities:				
Credit trading funds	**12.5**	39.5	**12.5**	39.5
Structured investment vehicles	**2.7**	31.4	**2.7**	31.4
Other floating rate notes	**726.5**	733.9	**726.5**	733.9
	2,208.6	2,338.3	**1,787.1**	1,893.1
	2,231.7	2,430.9	**1,810.2**	1,985.7

Other floating rates relates to sterling, euro and US dollar denominated FRN's with maturities ranging from 4 months to 4 years from the balance sheet date.

All amounts are stated in £m unless otherwise indicated

14. Debt securities (continued)

Comparisons of debt securities under different IAS 39 classifications

The following table illustrates the impact on profit or loss of debt securities (other than those classified as at fair value through profit or loss) if they had have been classified as fair value through profit or loss and accounted for at amortised cost.

	Group 2008	Bank 2008
If all investments in debt instruments had been:		
Classified as financial assets at fair value through profit or loss	(23.7)	(25.1)
Accounted for at amortised cost	–	–

The following table allows comparison of debt securities (other than those classified as at fair value through profit or loss) on the basis of the current carrying amount, fair value and amortised cost (before impairment losses):

Group	Carrying amount	Fair value	Amortised cost
Investments in debt securities as:	2008	2008	2008
Available for sale financial assets	2,108.3	2,108.3	2,131.2
Loans and receivables at amortised cost	123.4	112.3	145.9
	2,231.7	**2,220.6**	**2,277.1**

Bank	Carrying amount	Fair value	Amortised cost
Investments in debt securities as:	2008	2008	2008
Available for sale financial assets	1,686.8	1,686.8	1,710.0
Loans and receivables at amortised cost	123.4	112.3	145.9
	1,810.2	**1,799.1**	**1,855.9**

15. 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 a legal right of offset.

Derivatives held for trading purposes

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

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.

All amounts are stated in £m unless otherwise indicated

15. Derivative financial instruments (continued)

2008	Group: Contractual/notional amount	Group: Fair values Assets	Group: Fair values Liabilities	Bank: Contractual/notional amount	Bank: Fair values Assets	Bank: Fair values Liabilities
Derivatives held for trading						
Interest rate derivatives:						
Interest rate swaps	**2,399.0**	**68.0**	**(59.2)**	**2,619.0**	**73.4**	**(64.5)**
Over the Counter (OTC) interest rate options	**303.2**	**3.3**	**(3.3)**	**303.2**	**3.3**	**(3.3)**
Total OTC derivatives	**2,702.2**	**71.3**	**(62.5)**	**2,922.2**	**76.7**	**(67.8)**
Total derivative assets/(liabilities) held for trading	**2,702.2**	**71.3**	**(62.5)**	**2,922.2**	**76.7**	**(67.8)**
Derivatives held for hedging						
Derivatives designated as cash flow hedges:						
Interest rate swaps	**3,591.0**	**112.0**	**(29.5)**	**3,481.0**	**106.6**	**(29.5)**
Derivatives designated as fair value hedges:						
Interest rate swaps	**152.0**	**–**	**(1.5)**	**152.0**	**–**	**(1.5)**
Total derivative assets/(liabilities) designated as hedges	**3,743.0**	**112.0**	**(31.0)**	**3,633.0**	**106.6**	**(31.0)**
Derivatives held for non-trading purposes for which hedge accounting has not been applied:						
Interest rate swaps	**1,271.4**	**1.7**	**(12.6)**	**3,267.6**	**32.1**	**(12.6)**
Embedded derivatives – options	**394.0**	**9.5**	**(8.0)**	**394.0**	**9.5**	**(8.0)**
Forward currency transactions	**533.8**	**8.5**	**(3.8)**	**533.8**	**8.5**	**(3.8)**
Total derivative assets/(liabilities) held for non trading	**5,942.2**	**131.7**	**(55.4)**	**7,828.4**	**156.7**	**(55.4)**
Total recognised derivative assets/(liabilities)	**8,644.4**	**203.0**	**(117.9)**	**10,750.6**	**233.4**	**(123.2)**

2007	Group: Contractual/notional amount	Group: Fair values Assets	Group: Fair values Liabilities	Bank: Contractual/notional amount	Bank: Fair values Assets	Bank: Fair values Liabilities
Derivatives held for hedging						
Interest rate derivatives:						
Interest rate swaps	1,450.3	9.1	(7.5)	1,620.3	10.0	(8.2)
Over the Counter (OTC) interest rate options	136.4	0.5	(0.5)	136.4	0.5	(0.5)
Total OTC derivatives	1,586.7	9.6	(8.0)	1,756.7	10.5	(8.7)
Total derivative assets/(liabilities) held for trading	1,586.7	9.6	(8.0)	1,756.7	10.5	(8.7)
Derivatives held for hedging						
Derivatives designated as cash flow hedges:						
Interest rate swaps	2,376.9	10.7	(12.4)	2,291.9	10.1	(12.3)
Total derivative assets/(liabilities) designated as hedges	2,376.9	10.7	(12.4)	2,291.9	10.1	(12.3)
Derivatives held for non-trading purposes for which hedge accounting has not been applied:						
Interest rate swaps	709.0	0.6	(3.9)	709.0	0.6	(3.9)
Embedded derivatives – options	600.0	66.9	(66.5)	600.0	66.9	(66.4)
Forward currency transactions	115.8	0.4	(1.5)	115.8	0.4	(1.5)
Total derivative assets/(liabilities) held for non trading	3,801.7	78.6	(84.3)	3,716.7	78.0	(84.1)
Total recognised derivative assets/(liabilities)	5,388.4	88.2	(92.3)	5,473.4	88.5	(92.8)

All amounts are stated in £m unless otherwise indicated

15. Derivative financial instruments (continued)

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. During the reporting period there were no forecast transactions for which hedge accounting had previously been used but it is no longer expected to occur.

During the year the Bank has entered into fair value hedges to mitigate price movements due to interest rate sensitivities.

The number of non-margin exchange traded contracts held by the Bank at the year-end was nil (2007: nil).

16. Equity shares

	Group and Bank	
	2008	2007
Investment securities – unlisted	**13.0**	8.8
Included above are the following trade investments:		
Vocalink Limited **3,499,900** ordinary shares of £1 each (2007: 3,499,900)	**8.7**	8.7
Visa Inc **112,901** ordinary shares of $0.0001 each (2007: nil)	**4.2**	–
	12.9	8.7

Equity shares are classified as available for sale.

During 2008, Visa International restructured forming two new entities, Visa Inc and Visa Europe Limited. As members of Visa International, the Bank received shares in the Visa Inc entity with a fair value of £3.5m and also £5.8m cash proceeds that have been recognised in other operating income. Subsequently £0.7m revaluation gains on these shares have been recognised in equity.

During 2007, BACS Limited and LINK Interchange Network Limited merged to form Vocalink Limited. As a result, the Bank revalued its shareholding of the newly formed company. There has been no issued valuation update for the equity holding in 2008.

17. Intangible fixed assets

	Group		Bank	
	2008	2007	**2008**	2007
Cost				
At the beginning of the year	**22.8**	21.2	**21.7**	20.3
Additions	**–**	1.6	**–**	1.4
Disposals	**(3.3)**	–	**(3.3)**	–
At the end of the year	**19.5**	22.8	**18.4**	21.7
Accumulated amortisation				
At the beginning of the year	**17.6**	14.0	**17.4**	14.0
Disposals	**(3.3)**	–	**(3.3)**	–
Charge for the year	**2.9**	3.6	**2.8**	3.4
At the end of the year	**17.2**	17.6	**16.9**	17.4
Net book value				
Net book value at the end of the year	**2.3**	5.2	**1.5**	4.3
Net book value at the beginning of the year	**5.2**	7.2	**4.3**	6.3

All amounts are stated in £m unless otherwise indicated

18. Property, plant and equipment

	Freehold and leasehold buildings	Computer and other equipment	Total
2008			
Group:			
Cost			
At the beginning of the year	**10.3**	**175.9**	**186.2**
Additions	**–**	**0.3**	**0.3**
Disposals	**(0.2)**	**(32.0)**	**(32.2)**
At the end of the year	**10.1**	**144.2**	**154.3**
Accumulated depreciation			
At the beginning of the year	**3.3**	**103.1**	**106.4**
Disposals	**(0.1)**	**(28.8)**	**(28.9)**
Charge for the year	**0.3**	**16.9**	**17.2**
At the end of the year	**3.5**	**91.2**	**94.7**
Net book value			
Net book value at the end of the year	**6.6**	**53.0**	**59.6**
Net book value at the beginning of the year	7.0	72.8	79.8
2008			
Bank:			
Cost			
At the beginning of the year	**2.8**	**173.9**	**176.7**
Additions	**–**	**–**	**–**
Disposals	**(0.2)**	**(32.0)**	**(32.2)**
At the end of the year	**2.6**	**141.9**	**144.5**
Accumulated depreciation			
At the beginning of the year	**1.0**	**101.7**	**102.7**
Disposals	**(0.1)**	**(28.8)**	**(28.9)**
Charge for the year	**0.1**	**16.7**	**16.8**
At the end of the year	**1.0**	**89.6**	**90.6**
Net book value			
Net book value at the end of the year	**1.6**	**52.3**	**53.9**
Net book value at the beginning of the year	1.8	72.2	74.0
2007			
Group:			
Cost			
At the beginning of the year	10.3	182.1	192.4
Additions	–	13.1	13.1
Disposals	–	(19.3)	(19.3)
At the end of the year	10.3	175.9	186.2
Accumulated depreciation			
At the beginning of the year	3.1	95.5	98.6
Disposals	–	(11.3)	(11.3)
Charge for the year	0.2	18.9	19.1
At the end of the year	3.3	103.1	106.4
Net book value			
Net book value at the end of the year	7.0	72.8	79.8
Net book value at the beginning of the year	7.2	86.6	93.8

All amounts are stated in £m unless otherwise indicated

18. Property, plant and equipment (continued)

	Freehold and leasehold buildings	Computer and other equipment	Total
2007			
Bank:			
Cost			
At the beginning of the year	2.8	178.9	181.7
Additions	–	12.8	12.8
Disposals	–	(17.8)	(17.8)
At the end of the year	2.8	173.9	176.7
Accumulated depreciation			
At the beginning of the year	1.0	92.9	93.9
Disposals	–	(9.8)	(9.8)
Charge for the year	–	18.6	18.6
At the end of the year	1.0	101.7	102.7
Net book value			
Net book value at the end of the year	1.8	72.2	74.0
Net book value at the beginning of the year	1.8	86.0	87.8

	Group		Bank	
	2008	2007	**2008**	2007
The net book value of land and buildings comprises:				
Freehold	**6.6**	7.0	**1.6**	1.8
Short leasehold	**–**	–	**–**	–
	6.6	7.0	**1.6**	1.8

All land and buildings are occupied by the Group for its own activities. Included within property, plant and equipment are finance leased assets. At 10 January 2009, the net book value of these assets was £nil (2007: £nil).

19. Other assets

	Group		Bank	
	2008	2007	**2008**	2007
Trade debtors	**2.8**	3.1	**2.8**	3.1
Other assets	**28.4**	13.4	**28.2**	13.3
	31.2	16.5	**31.0**	16.4

20. Deposits by banks

	Group		Bank	
	2008	2007	**2008**	2007
Items in course of collection	**5.3**	5.6	**5.3**	5.6
Deposits from other banks	**1,067.0**	655.7	**1,067.0**	655.7
	1,072.3	661.3	**1,072.3**	661.3
of which:				
Variable rate	**9.7**	54.2	**9.7**	54.2
Fixed rate	**1,062.6**	607.1	**1,062.6**	607.1

21. Customer accounts

	Group		Bank	
	2008	2007	**2008**	2007
Variable rate	**9,513.1**	9,187.2	**11,073.3**	8,784.3
Fixed rate	**2,395.7**	1,372.3	**2,315.4**	1,283.8
	11,908.8	10,559.5	**13,388.7**	10,068.1

All amounts are stated in £m unless otherwise indicated

22. Debt securities in issue

	Group		Bank	
	2008	2007	**2008**	2007
Certificates of deposit	**526.2**	427.2	**526.2**	427.2
Commercial paper	**41.8**	108.6	**41.8**	108.6
	568.0	535.8	**568.0**	535.8

23. Other borrowed funds

	Group		Bank	
	2008	2007	**2008**	2007
£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	**60.0**	60.0
Subordinated Notes 2021	**150.0**	150.0	**150.0**	150.0
Issue costs and discount	**(1.6)**	(1.9)	**(1.6)**	(1.9)
	358.4	358.1	**358.4**	358.1

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.

Subordinated Notes due November 2021

The Notes were issued on 16 November 2006 at a discount of 0.189%.

The Notes are an unsecured obligation of the Bank and in the event of a 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 5.625% per annum up to and including the interest payment date on 16 November 2016, when the interest basis changes to floating rate. During the fixed rate period, interest is payable semi-annually in arrears on 16 May and 16 November.

From 17 November 2016, the Notes carry a floating interest rate of 3 month LIBOR plus a margin of 1.75%. Interest is payable quarterly in arrears on 16 February, 16 May, 16 August and 16 November, commencing on the interest payment date falling in February 2017 up to and including the maturity date.

The Bank may redeem all, but not less than all, of the Notes at the principal amount on 16 November 2016, and on any quarterly interest payment date thereafter.

24. Other liabilities

	Group		Bank	
	2008	2007	**2008**	2007
Creditors	**91.7**	103.8	**109.6**	102.5

All amounts are stated in £m unless otherwise indicated

25. Provision for liabilities

	2008					2007			
Group	**Property**	**Restructuring**	**Compensation**	**FSCS levy**	**Total**	Property	Restructuring	Compensation	Total
At the beginning of the year	**5.7**	**2.8**	**0.9**	**–**	**9.4**	5.5	–	1.3	6.8
Utilised	**(0.8)**	**(2.8)**	**–**	**–**	**(3.6)**	(1.5)	(8.2)	(0.1)	(9.8)
Profit and loss charge	**0.2**	**–**	**(0.7)**	**10.5**	**10.0**	1.7	11.0	(0.3)	12.4
At the end of the year	**5.1**	**–**	**0.2**	**10.5**	**15.8**	5.7	2.8	0.9	9.4

	2008					2007			
Bank	**Property**	**Restructuring**	**Compensation**	**FSCS levy**	**Total**	Property	Restructuring	Compensation	Total
At the beginning of the year	**5.3**	**2.8**	**0.7**	**–**	**8.8**	5.0	–	0.9	5.9
Utilised	**(0.8)**	**(2.8)**	**–**	**–**	**(3.6)**	(1.4)	(8.2)	(0.1)	(9.7)
Profit and loss charge	**–**	**–**	**(0.7)**	**10.2**	**9.5**	1.7	11.0	(0.1)	12.6
At the end of the year	**4.5**	**–**	**–**	**10.2**	**14.7**	5.3	2.8	0.7	8.8

Payments under future unavoidable lease commitments, net of amounts receivable under sub-lettings, are due on leases terminating between 2008 and 2020.

The Financial Services Compensation Scheme provides compensation to customers of financial institutions in the event that an institution is unlikely, or is likely to be unable, to pay claims against it. As a result of a number of institutions failures during the year the FSCS has borrowed £19.7 billion on an interest only basis until September 2011 from HM Treasury in order to meet its obligations to the depositors. These borrowings are anticipated to be repaid wholly or substantially from the realisation of the assets of the failed institutions. The FSCS raises annual levies from the banking industry in order to meet its management expenses and compensation costs. The annual levies are based upon the individual institutions proportion of protected deposits of the total market protected deposits at 31 December of each year. The Group has provided for £10.5m for its share of levies that will be raised by the FSCS including the interest on the loan from the HM Treasury in respect of the levy years to 31 March 2010. The provision includes estimates for the interest FSCS will pay on the loan and of the Groups market participation in the relevant periods.

At the date of these financial statements, it is not possible to estimate whether there will be ultimately additional levies on the industry, the level of the Group's market participation or other factors that may affect amounts or the timing of amounts that may ultimately become payable, nor the effect that such levies may have upon operating results in any particular periods.

26. Deferred tax

Deferred taxes are calculated on all temporary differences under the liability method using an effective tax rate of 28% (2007: 30%).

The movement on the deferred tax accounts are as follows:

	Group		**Bank**	
	2008	2007	**2008**	2007
Net deferred tax at the beginning of the year	**(6.2)**	1.9	**(0.7)**	8.3
Income statement credit	**2.5**	2.3	**1.6**	1.3
Charged to equity				
Unrealised appreciation on investments	**(0.2)**	(2.2)	**(0.3)**	(2.2)
Pension fund deficit	**–**	–	**–**	
Cash flow hedges	**(23.1)**	(8.2)	**(23.1)**	(8.1)
Net deferred tax at the end of the year	**(27.0)**	(6.2)	**(22.5)**	(0.7)

Net deferred tax comprises:				
Deferred tax asset	**4.6**	5.4	**4.3**	5.3
Deferred tax liability	**(31.6)**	(11.6)	**(26.8)**	(6.0)
	(27.0)	(6.2)	**(22.5)**	(0.7)

All amounts are stated in £m unless otherwise indicated

26. Deferred tax (continued)

	Group		Bank	
	2008	2007	**2008**	2007
Deferred taxation				
Cash flow hedges	**(22.6)**	0.5	**(22.6)**	0.6
Unrealised appreciation on investments	**(2.2)**	(2.2)	**(2.2)**	(2.2)
Capital allowances on fixed assets	**(1.5)**	(3.6)	**(1.1)**	(3.2)
Capital allowances on assets leased to customers	**(4.4)**	(6.4)	**(0.2)**	(1.1)
Other temporary differences	**3.7**	5.1	**3.6**	5.2
Restatement of deferred tax to 28%	**–**	0.4	**–**	–
	(27.0)	(6.2)	**(22.5)**	(0.7)

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

	Group		Bank	
	2008	2007	**2008**	2007
Capital allowances on fixed assets	**(1.9)**	(1.3)	**(1.9)**	(1.3)
Capital allowances on assets leased to customers	**(1.7)**	(1.4)	**(0.8)**	(0.7)
Other temporary differences	**1.1**	0.8	**1.1**	0.7
Restatement of deferred tax to 28%	**–**	(0.4)	**–**	–
	(2.5)	(2.3)	**(1.6)**	(1.3)

27. Pensions

Defined contribution basis

With effect from 6 April 2006 the Bank Group, along with other businesses within the Co-operative Group, has participated in the Co-operative Group Pension (Average Career Earnings) Scheme (the PACE scheme). This Scheme is a defined benefit scheme, the assets of which are held in a separate fund administered by trustees. As a Group-wide pension scheme, the PACE scheme exposes the participating businesses to actuarial risks associated with the current and former employees of other Group companies, with the result that there is no consistent and reliable basis for allocating liabilities, assets and costs to individual companies participating in the Scheme. Therefore the pension cost shown in these accounts in respect of the Scheme for the period after 6 April 2006 is the actual contribution paid by the Bank.

Key assumptions of the Group pension scheme

The key aspects of Co-operative Group Limited's pension scheme are as follows:

	2008	2007
The principal assumptions used to determine the liabilities of the Group's pension schemes were:		
Discount rate	**5.70%**	5.65%
Rate of increase in salaries	**4.75%**	5.15%
Future pension increases where capped at 5.0% pa	**3.25%**	3.65%
Future pension increases where capped at 2.50% pa	**2.50%**	2.50%
Assumptions used to determine net pension cost for the PACE scheme are:		
	5.65%	5.10%
Expected long term return on scheme assets	**6.40%**	6.30%
Rate of increase in salaries	**5.15%**	4.50%
Assumptions used to determine net pension cost for the former United Co-operatives schemes are:		
Discount rate	**5.65%**	5.40%
Expected long term return on scheme assets	**6.50%**	7.30%
Rate of increase in salaries	**5.15%**	4.80%

The average life expectancy (in years) for mortality tables used to determine scheme liabilities for the PACE scheme and the former United Co-operatives schemes at 10 January 2009 is:

Life expectancy at age 65	**Male**	**Female**
Member currently aged 65 (current life expectancy)	**20.3**	**23.2**
Member currently aged 45 (life expectancy at age 65)	**21.3**	**24.1**

27. Pensions (continued)

The amounts recognised in the balance sheet of the Co-operative Group are as follows:

	2008 £m	2007 £m
Present value of funded obligations	**(4,799.9)**	(5,073.6)
Present value of unfunded liabilities	**(3.5)**	(3.7)
Fair value of plan assets	**5,204.6**	5,511.7
	401.2	434.4

The pension scheme assets include property occupied by the Group at fair value of £1.1m (2007: £1.1m)

	2008 £m	2007 £m
The weighted-average asset allocations at the year-end were as follows:		
Equities	**42%**	43%
Liability-driven investments	**54%**	21%
Property	**4%**	5%
Cash	**0%**	1%

To develop the expected long term rate of return on assets assumption, the Group considered the current level of expected returns on risk free investments (primarily government bonds), the historical level of the risk premium associated with the other asset classes in which the portfolio is invested and the expectations for future returns of each asset class. The expected return for each asset class was then weighted based on the target asset allocation to develop the expected long term rate of return on assets assumption for the portfolio. This resulted in the selection of the 6.4% assumption for the year ended 10 January 2009.

Bank (unfunded) pension scheme

The Bank also operates a small unfunded pension scheme.

	2008	2007	2006
Expected return on scheme assets	**N/A**	N/A	N/A
Rate of increase of pensions in payment	**3.3%**	3.4%	2.9%
Rate of increase in salaries	**4.8%**	4.9%	4.4%
Discount rate	**5.7%**	5.7%	4.9%

The assumptions used by the actuary were 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 values of the assets and liabilities of the unfunded pension scheme were:

	Group		Bank	
	2008	2007	2008	2007
Present value of unfunded obligations	**(3.2)**	(3.5)	**(3.2)**	(3.5)
Deficit in the scheme	**(3.2)**	(3.5)	**(3.2)**	(3.5)
Related deferred tax asset	**0.9**	1.0	**0.9**	1.0
Net pension liability	**(2.3)**	(2.5)	**2.3**	(2.5)

The unfunded obligation has been reclassified to be shown within other liabilities.

	Group 2008	Group 2007	Bank 2008	Bank 2007
Analysis of amount charged to income statement:				
Current service cost	**–**	0.1	**–**	0.1
Interest on pension scheme liabilities	**0.2**	0.2	**0.2**	0.2
	0.2	0.3	**0.2**	0.3

All amounts are stated in £m unless otherwise indicated

27. Pensions (continued)

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

	Group		Bank	
	2008	2007	**2008**	2007
Opening defined benefit liabilities	**3.5**	3.1	**3.5**	3.1
Current service cost	**–**	0.1	**–**	0.1
Interest on liabilities	**0.2**	0.2	**0.2**	0.2
Actuarial (gains)/losses	**(0.4)**	0.3	**(0.4)**	0.3
Benefits paid	**(0.1)**	(0.2)	**(0.1)**	(0.2)
Closing defined benefit liabilities	**3.2**	3.5	**3.2**	3.5

Amounts recognised in the statement of recognised income and expense:

	Group		Bank	
	2008	2007	**2008**	2007
Actuarial gains/(losses) on scheme liabilities during period	**0.4**	(0.3)	**0.4**	(0.3)
Actuarial gains on scheme assets during period	**–**	–	**–**	–
Total scheme gains/(losses) during period	**0.4**	(0.3)	**0.4**	(0.3)

The amounts for the current period are as follows:

	Group		Bank	
	2008	2007	**2008**	2007
Defined benefit obligation	**(3.2)**	(3.5)	**(3.2)**	(3.5)
Scheme assets	**–**	–	**–**	–
Deficit	**(3.2)**	(3.5)	**(3.2)**	(3.5)
Experience adjustment on scheme liabilities	**–**	–	**–**	–
Experience adjustment on scheme assets	**–**	–	**–**	–

28. Share capital

	Group and Bank	
	2008	2007
Authorised		
1,100,000,000 ordinary shares of 5p each	**55.0**	55.0
Allotted, called up and fully paid		
1,100,000,000 ordinary shares of 5p each	**55.0**	55.0
Share premium account	**8.8**	8.8
	63.8	63.8

The shareholders have one vote for every share held.

29. Reserves and retained earnings

	Group	Bank
Retained earnings		
At 13 January 2007	**633.7**	608.3
Net profit/(loss) for year	3.2	(1.1)
Dividend	(9.0)	(9.0)
Retirement benefit schemes	(0.3)	(0.3)
At 12 January 2008	**627.6**	597.9

All amounts are stated in £m unless otherwise indicated

29. Reserves and retained earnings (continued)

	Group	Bank
Net profit for year	13.5	12.4
Dividend	–	–
Retirement benefit schemes	0.4	0.4
At 10 January 2009	**641.5**	610.7

	Group		Bank	
	2008	2007	**2008**	2007
Other reserves				
Revaluation reserve – available for sale investments	**(16.6)**	(0.2)	**(16.8)**	(0.2)
Hedging reserve – cash flow hedges	**59.1**	(1.2)	**58.2**	(1.2)
	42.5	(1.4)	**41.4**	(1.4)

	Group		Bank	
	2008	2007	**2008**	2007
Revaluation reserve – available for sale investments				
At the beginning of the year	**(0.2)**	(2.2)	**(0.2)**	(2.1)
Net (losses)/gains from changes in fair value	**(57.7)**	(28.7)	**(58.0)**	(28.8)
Losses recycled to profit or loss on impairment	**31.7**	31.8	**31.7**	31.8
Income tax	**7.4**	(0.9)	**7.5**	(0.9)
Net gains/(losses) transferred to net profit on disposal	**3.1**	(0.3)	**3.1**	(0.3)
Deferred tax	**(0.9)**	0.1	**(0.9)**	0.1
At the end of the year	**(16.6)**	(0.2)	**(16.8)**	(0.2)

Revaluation reserve

The revaluation reserve includes the cumulative net change in the fair value of available for sale investments, excluding impairment losses, until the investment is derecognised or impaired.

	Group		Bank	
Hedging reserve – cash flow hedges	**2008**	2007	**2008**	2007
At the beginning of the year	**(1.2)**	(20.5)	**(1.2)**	(20.4)
Gains from changes in fair value	**82.9**	28.3	**81.7**	28.1
Deferred tax	**(23.4)**	(8.5)	**(23.1)**	(8.4)
Transferred to net profit	**0.8**	(0.5)	**0.8**	(0.5)
At the end of the year	**59.1**	(1.2)	**58.2**	(1.2)

Hedging reserve

The hedging reserve comprises the effective portion of the cumulative net change in the fair value of cash flow hedging instruments related to hedged transactions that have not yet affected profit or loss.

Minority Interests	Group	
	2008	2007
At the beginning of the year	**26.9**	24.4
Profit for the year	**3.8**	2.7
Net gains on available for sale investments	**0.7**	0.2
Net gains on cash flow hedges	**2.4**	0.5
Dividends	**(0.9)**	(0.9)
At the end of the year	**32.9**	26.9

Dividends

After the balance sheet date no dividends were proposed by the Directors (2007: nil).

All amounts are stated in £m unless otherwise indicated

30. Statement of changes in equity

	Group		Bank	
	2008	2007	**2008**	2007
Equity at the beginning of the year	**716.9**	699.2	**660.3**	649.6
Total recognised income and expense for the year	**64.7**	27.6	**55.6**	19.7
Dividend – equity shareholders	**–**	(9.0)	**–**	(9.0)
Dividend – minority interests	**(0.9)**	(0.9)	**–**	–
Equity at the end of the year	**780.7**	716.9	**715.9**	660.3

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 Capital Requirements Directive (CRD).

The contingent liabilities of the Group and the Bank as detailed below arise in the normal course of banking business and it is not practical to quantify their future financial effect.

	Contract amount 2008	**Credit equivalent amount (i) 2008**	**Average risk weight 2008**	**Risk weighted amount 2008**	Contract amount 2007	Risk weighted amount 2007
Group						
Contingent liabilities:						
Guarantees and irrevocable letters of credit	**94.9**	**80.2**	**92.9%**	**74.5**	90.9	48.0
	94.9	**80.2**			90.9	48.0
Bank						
Contingent liabilities:						
Guarantees and irrevocable letters of credit	**92.3**	**78.9**	**92.4%**	**72.9**	87.6	46.3
	92.3	**78.9**			87.6	46.3
Group						
Other commitments:						
Documentary credits and short term trade-related transactions	**3.4**	**0.7**	**85.7%**	**0.6**	1.6	0.2
Forward assets purchases and forward deposit placed	**200.0**	**200.0**	**14.6%**	**29.2**	215.0	13.8
Undrawn formal standby facilities, credit lines and other commitments to lend (includes revocable and irrevocable commitments).	**5,300.4**	**2,993.6**	**36.7%**	**1,098.7**	6,155.1	1,364.6
	5,503.8	**3,194.3**	**35.3%**	**1,128.5**	6,371.7	1,378.6
Bank						
Other commitments:						
Documentary credits and short term trade-related transactions	**3.4**	**0.7**	**85.7%**	**0.6**	1.6	0.2
Forward assets purchases and forward deposit placed	**200.0**	**200.0**	**14.6%**	**29.2**	215.0	13.8
Undrawn formal standby facilities, credit lines and other commitments to lend (includes revocable and irrevocable commitments).	**5,292.5**	**2,993.6**	**36.7%**	**1,098.7**	6,147.8	1,364.6
	5,495.9	**3,194.3**	**35.3%**	**1,128.5**	6,364.4	1,378.6

All amounts are stated in £m unless otherwise indicated

31. Contingent liabilities and commitments (continued)

Notes

i) Under the CRD Credit conversion factors are applied to exposures subject to the Standardised and Foundation IRB approach, primarily Corporate and Wholesale exposures as defined by BIPRU. Under the Retail IRB approach the Credit Equivalent amount is defined as Exposure at Default (EAD).

ii) Undrawn loan commitments include revocable commitments which are unused credit card limits of £3,034.1m (2007: £3,624.2m).

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	
	2008	2007	**2008**	2007
Balances with central banks	**9.9**	11.3	**–**	–

Operating lease commitments

	2008 Land and buildings	2007 Land and buildings
At the year-end, the future minimum lease payments under non-cancellable operating leases were:		
Group		
Expiring:		
Within one year	**1.2**	1 . 4
Between one and five years	**7.4**	4.1
In five years or more	**94.3**	105.4
	102.9	110.9
Bank		
Expiring:		
Within one year	**1.2**	1.4
Between one and five years	**6.9**	3.3
In five years or more	**99.6**	109.6
	107.7	114.3

The Group leases a number of branch and office premises under operating leases. The leases typically run for a period of up to 25 years, with an option to renew the lease after that period. Lease payments are generally reviewed every 3 to 5 years to reflect market rentals.

Informal (unauthorised) overdraft charges

In July 2007 the Office of Fair Trading (OFT) agreed with eight financial institutions to commence proceedings in the High Court of England and Wales in a test case regarding informal overdraft charges. The Co-operative Bank is not part of the proceedings but will be bound by the outcome.

In April 2008, the High Court issued its Judgement in respect of the first stages of the test case process.

The Courts Judgement was that informal overdrafts are an essential, real and identifiable service provided by banks for their personal current account customers, that the institutions' current overdraft charges are not unenforceable penalties, but are assessable for fairness under the Unfair Terms in Consumer Contracts Regulations 1999 and most of the litigant banks' current terms and conditions (including charges) are in plain and intelligible language. The financial institutions appealed the fairness ruling.

In February 2009 the Court of Appeal decided that the OFT can assess where the litigant banks' terms and conditions, allowing them to impose informal overdraft bank charges, are fair. However, the litigant banks have indicated that they intend to apply to the House of Lords to seek permission to appeal against this Judgement.

Pending resolution of the test case, and the Financial Services Authority (FSA) has granted banks, subject to conditions, a waiver from processing complaints received from customers in respect of current account overdraft charges. In January 2009 the FSA renewed the waiver for up to a further six month period until 26 July 2009 to facilitate the test case process. All outstanding court proceedings issued against the Bank are currently stayed. However, individual claimants are able to apply for the stay to be lifted on hardship grounds where appropriate.

A range of outcomes is possible from the test case and any appeals, some of which would have significant impact on the Group. Therefore it is not considered appropriate at this stage to reliably estimate the financial impact on the Group and no provision has been made.

All amounts are stated in £m unless otherwise indicated

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 England and is registered under the Industrial and Provident Societies Acts. The ultimate holding organisation is the Co-operative Group Limited (formally known as Co-operative Group (CWS) Limited), which is incorporated in England and is registered under the Industrial and Provident Societies Acts. 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 and operate in England, and none of which are quoted, are:

Operating subsidiaries	**Nature of business**	**Total issued share capital at 10 January 2009**	**Group interest 2008**	Group interest 2007
Unity Trust Bank plc*	Banking	16,429,301 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%
Co-operative Bank Financial Advisers Limited	Financial advisers	1,600,000 Ordinary shares of £1 each	**100%**	100%
The Covered Bond LLP	Mortgage acquisition and guarantor of covered bonds	Nil	**100%**	–

* Held through subsidiary undertaking

Investments in group undertakings:

Shares and loans in group undertakings:	**Cost 2008**	**Impairment provision 2008**	**Carrying value 2008**	Cost 2007	Impairment provision 2007	Carrying value 2007
At the beginning of the year	**3.1**	**(0.4)**	**2.7**	3.1	(0.4)	2.7
Additions	**1,320.6**	**–**	**1,320.6**	–	–	–
Repayments	**(354.0)**	**–**	**(354.0)**	–	–	–
At the end of the year	**969.7**	**(0.4)**	**969.3**	3.1	(0.4)	2.7

The above provision is held against dormant subsidiaries.

During 2008, The Covered Bond LLP was established as a result of the issue of a £1 billion covered bond by the Bank. Loans and advances to customers of £2.3bn were transferred to the LLP (as described in note 13). The transfer was funded by a loan of £1 billion and capital contribution of £1.3 billion.

The Bank's interest in the Covered Bond LLP is in substance no different than a wholly owned subsidiary and consequently it is fully consolidated in the Group accounts. The accounting policy for Special Purpose Entities (SPEs) is disclosed on page 56.

Unity Trust Bank plc 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 plc. This provides the power to control.

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

All amounts are stated in £m unless otherwise indicated

32. Related party transactions (continued)

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	
	2008	2007
Loans outstanding at the beginning of the year	**1.3**	0.5
Interest and fee income earned	**–**	–
Net movement	**–**	0.8
Loans outstanding at the end of the year	**1.3**	1.3
Deposits at the beginning of the year	**2.4**	2.7
Interest and fee expense	**0.1**	0.2
Net movement	**(0.5)**	(0.5)
Deposits at end of the year	**2.0**	2.4

	Associated companies			
	Group		Bank	
	2008	2007	**2008**	2007
Loans at the beginning of the year	**92.9**	–	**126.4**	34.9
Interest and fee income earned	**2.1**	4.0	**2.9**	5.2
Net movement	**42.9**	88.9	**1,040.2**	86.3
Loans at the end of the year	**137.9**	92.9	**1,169.5**	126.4
Deposits at the beginning of the year	**234.2**	201.9	**234.2**	203.8
Interest and fee income earned	**–**	(0.4)	**–**	(0.4)
Interest and fee income paid	**4.3**	2.3	**4.3**	2.3
Net movement	**(19.5)**	30.4	**(19.5)**	28.5
Deposits at the end of the year	**219.0**	234.2	**219.0**	234.2
Loans to banks include:				
Due from subsidiary undertakings	**–**	–	**10.8**	7.4
Loans to customers include:				
Due from subsidiary undertakings	**–**	–	**1,031.6**	26.1
Due from parent undertakings	**108.0**	84.0	**108.0**	84.0
Due from fellow subsidiary undertakings	**29.9**	8.9	**29.9**	8.9
Deposits by banks include:				
Due to subsidiary undertakings	**–**	–	**–**	–
Customer accounts include:				
Due to subsidiary undertakings	**–**	–	**3.5**	3.7
Due to parent undertakings	**107.4**	92.2	**107.4**	92.2
Due to fellow subsidiary undertakings	**118.1**	139.0	**118.1**	139.0
Due to associated undertakings	**–**	–	**–**	–

All amounts are stated in £m unless otherwise indicated

32. Related party transactions (continued)

Key management compensation

	Group and Bank	
	2008	2007
Salaries and other short term benefits	**3.9**	4.3
Termination benefits	**0.7**	0.4
	4.6	4.7

Directors' remuneration

A listing of the members of the Board of Directors is shown on pages 26 and 27.
The total remuneration of the Directors was £3.2m (2007: £3.2m).

Further details of Directors' remuneration are provided on pages 37 to 42.

33. Events after the balance sheet date

On 29 January 2009 the Bank announced it was proposing to merge with Britannia Building Society. The announcement followed the change in the law permitting co-operatives and mutuals to merge. The Co-operative Group Limited and Co-operative Financial Services Limited Boards approved the merger on 20 January 2009, however the merger is subject to the Britannia members agreement which is scheduled to take place in April 2009.

On 26 January 2009, the Bank issued £120 million of share capital to its parent company, Co-operative Financial Services Limited to reinforce its capital strength and give the Bank eligibility to the Governments Credit Guarantee Scheme. Given the Bank's strong retail funding position any guaranteed issuance is currently unlikely.

Responsibility statement

All amounts are stated in £m unless otherwise indicated

We confirm that to the best of our knowledge:

- the condensed set of financial statements has been prepared in accordance with IFRS's as adopted by the EU; and

- the management report includes a fair view of the information required by:
  - DTR 4.1.8R of the *Disclosure and Transparency Rules*, being a fair review of the business and a description of the principal risks and uncertainties.

  - DTR 4.1.9R of the *Disclosure and Transparency Rules*, being a balanced and comprehensive analysis of the development and performance of the business during the financial year and the position of the business and the end of the year.

  - D 4.1.11R of the *Disclosure and Transparency Rules*, being an indication of any important events that have occurred since the end of the financial year, likely future developments, information concerning acquisitions, the existence of branches and the use of financial instruments and the risk management objectives, policies and exposures of these instruments.

By order of the Board.

David Anderson
Chief Executive
2 April 2009

Consolidated income statement history

For the year ended 10 January 2009
All amounts are stated in £m unless otherwise indicated

	2005	2006	2007	2008	Change £m	Change %
Net interest income	320.5	320.3	334.8	**374.3**	39.5	12%
Non-interest income	205.9	201.2	188.7	**195.1**	6.4	3%
Operating income	**526.4**	**521.5**	**523.5**	**569.4**	**45.9**	**9%**
Operating costs	(328.8)	(339.9)	(339.3)	**(336.3)**	3.0	1%
FSCS levy	–	–	–	**(10.5)**	(10.5)	–
Profit before impairment losses	**197.6**	**181.6**	**184.2**	**222.6**	**38.4**	**21%**
Impairment losses on loans and advances	(99.8)	(105.3)	(102.0)	**(96.8)**	5.2	5%
Impairment losses on investments	–	–	(31.8)	**(50.7)**	(18.9)	(59%)
Operating profit	**97.8**	**76.3**	**50.4**	**75.1**	**24.7**	**49%**
Membership dividend	(1.3)	(1.2)	(1.3)	**(4.7)**	(3.4)	(262%)
Profit before taxation	**96.5**	**75.1**	**49.1**	**70.4**	**21.3**	**43%**
Significant items	–	109.2	(38.0)	**(47.1)**	(9.1)	24%
Income tax expense	(30.9)	(57.4)	(5.2)	**(6.0)**	(0.8)	(15%)
Profit for the year	**65.6**	**126.9**	**5.9**	**17.3**	**11.4**	**193%**
Minority interest	(2.4)	(2.2)	(2.7)	**(3.8)**	(1.1)	(41%)
Dividends	(18.8)	(4.2)	(9.0)	**–**	9.0	(100%)
Retentions	44.4	120.5	(5.8)	**13.5**	19.3	333%
Average numbers of staff	4,238	4,234	4,281	**3,990**		
Net interest margin	3.0%	2.7%	2.7%	**2.8%**		
Cost/income ratio	62.5%	65.2%	64.8%	**59.0%**		
Earnings per share	5.75p	11.22p	0.29p	**1.23p**		

Summarised balance sheet

At 10 January 2009
All amounts are stated in £m unless otherwise indicated

	2005	2006	2007	2008	Change £m	Change %
Lending						
Retail sector						
Visa	1,098.2	991.2	851.2	**734.9**	(116.3)	(14%)
Mortgages	3,227.2	3,145.2	3,310.8	**4,090.7**	779.9	24%
Other unsecured	1,166.2	1,039.4	943.6	**874.6**	(69.0)	(7%)
Total retail	5,491.6	5,175.8	5,105.6	**5,700.2**	594.6	12%
Corporate sector	2,331.5	2,818.7	3,543.4	**4,361.4**	818.0	23%
Wholesale customer lending	100.7	153.1	360.0	**244.7**	(115.3)	(32%)
Total Customer Lending	**7,923.8**	**8,147.6**	**9,009.0**	**10,306.3**	**1,297.3**	**14.4%**
Loans and advances to banks	1,170.7	1,367.0	1,204.0	**1,886.7**	682.7	57%
Debt securities	2,269.1	2,753.1	2,430.9	**2,231.7**	(199.2)	(8%)
Derivative financial instruments	68.2	84.4	88.2	**203.0**	114.8	130%
Equity shares	1.2	1.7	8.8	**13.0**	4.2	48%
Other assets	420.0	425.4	346.0	**323.4**	(22.6)	(7%)
Total Assets	**11,853.0**	**12,779.2**	**13,086.9**	**14,964.1**	**1,877.2**	**14.3%**
Deposits						
Retail sector	5,640.9	6,128.1	6,757.7	**7,936.0**	1,178.3	17%
Corporate sector	2,199.2	2,268.2	2,624.8	**3,206.4**	581.6	22%
Wholesale customer deposits	978.7	1,148.0	1,177.0	**766.4**	(410.6)	(35%)
Total Customer Deposits	**8,818.8**	**9,544.3**	**10,559.5**	**11,908.8**	**1,349.3**	**12.8%**
Deposits by banks	634.7	700.6	661.3	**1,072.3**	411.0	62%
Debt securities in issue	1,050.2	1,113.3	535.8	**568.0**	32.2	6%
Derivative financial instruments	63.7	117.7	92.3	**117.9**	25.6	28%
Other liabilities	320.9	216.3	163.0	**158.0**	(5.0)	(3%)
Subordinated debt	278.1	327.8	298.1	**298.4**	0.3	–
Preference share capital	60.0	60.0	60.0	**60.0**	0.0	–
Equity share capital, reserves	626.6	699.2	716.9	**780.7**	63.8	9%
Total Liabilities	**11,853.0**	**12,779.2**	**13,086.9**	**14,964.1**	**1,877.2**	**14.3%**

NOTICE IS HEREBY GIVEN that the Annual General Meeting of The Co-operative Bank p.l.c. will be held in the Committee Room, 13th floor, New Century House, Corporation Street, Manchester, M60 4ES, on 6 June 2009 at 9.00 am for the following purposes:

1. To receive the Notice convening the meeting.
2. To receive the Annual Report and adopt the Financial Statements for the year ended 10 January 2009 together with the Auditor's Report.
3. To approve the Remuneration Report for the year ended 10 January 2009.
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 28 November 2008 be confirmed;
   ii) that a dividend of 4.625p per £1 share be declared and paid on 29 May 2009 to the registered holders as at 1 May 2009 providing a dividend rate of 9.25 per cent per annum and making a total distribution of £5,550,000.
5. To re-elect the following Directors who retire by rotation, in accordance with the provisions of Article 105:
   i) Bob Burlton, Non-Executive Director;
   ii) Piers Williamson, Professional Independent Non-Executive Director.
6. To re-appoint the following Directors who were appointed to the Board since the last Annual General Meeting of the Company:
   i) Barry Tootell who was appointed to the Board on 4 April 2008;
   ii) Dick Parkhouse who was appointed to the Board on 22 August 2008.
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:
1 Balloon Street
Manchester M60 4EP
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
2 April 2009

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 9.00 am on 4 June 2009. 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 pages 26 and 27 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 Shares 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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The co-operative bank

Co-operative Bank p.l.c.
1 Ballon Street, Manchester M60 4EP
www.co-operativebank.co.uk
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