The Co-operative Bank plc

Building the compelling co-operative alternative

Financial statements 2011

Part of The **co-operative** banking group

The **co-operative**
good with money

Contents

About us: a guide to The Co-operative Bank

What is The Co-operative Bank?

The Co-operative Bank is part of The Co-operative Banking Group, providing a range of financial services to personal and business customers across the UK. The Banking Group's parent company, The Co-operative Group, is the world's largest consumer co-operative.

The Co-operative Bank operates under its own brand as well as those of **smile**, Platform and Britannia. We offer our services through 342 branches and 22 corporate banking centres as well as telephony and online channels.

We are a leader in the field of ethical investment and corporate social responsibility. Our customer driven ethical strategy was the first of its kind in our industry and we pursue an active strategy of community involvement.

What services do we provide?

We offer a broad range of financial services to both personal and corporate customers, including high street and internet banking; current accounts and credit cards; mortgages and loans; savings; a range of personal and commercial insurances; corporate finance and financial advice. In partnership with AXA Wealth we also offer a range of savings and investment services to our branch customers.

How do we provide them?

We believe that our customers should be able to access our services in the way and at the time that best suits their needs, so we offer our services via a number of channels including:

- face to face (via our Britannia and Co-operative Bank branch networks)
- over the telephone (via our customer contact centres)
- online

How do we do business?

We are renowned as a member owned, customer led and ethically guided business. In contrast with many shareholder owned competitors, we exist solely for the benefit of our members and customers. In 2011 our 'co-operative difference' was recognised by the Financial Times in naming us Europe's most sustainable bank for the second year running.

Our business strategy is driven by our **purpose**, **vision**, **values** and **givens**.

Our **purpose** represents who we are and why we are different from other financial services providers. The Co-operative Bank's purpose is to be a pioneering business delivering sustainable financial services for members and society.

Our **vision** is to become a compelling co-operative alternative in the markets in which we compete.

Our **values** describe what we stand for and ensure we are consistent in how we treat customers, members and colleagues.

As a co-operative:

- We put **members and customers first** in all we do
- We take **personal and social responsibility**
- Together we will create **a great place to work, grow and develop**
- We strive relentlessly to be **faster, better, more successful**
- We are open and fair and committed to **excellent communication**

Our **givens** are the building blocks that underpin our business:

- We champion **co-operative values, principles and ethics**
- We are **financially prudent and strong**
- We **share profits** with members
- We only do business **consistent with our values and principles**

About us: a guide to The Co-operative Bank continued

How do we measure our success?

The Co-operative Bank business strategy measures success in four key areas: financial, customer, people and process. This 'balanced scorecard' approach is a key reflection of our co-operative difference and helps us ensure that in all decisions we make as a business we focus on all implications of the decision. It also helps us to take a broad view of our progress towards our strategic vision.

The following table summarises our performance in 2011 against our key performance indicators.

The Board reviews performance evidence against each key performance indicator on a regular basis, and considers 2011's performance satisfactory in all areas. Details (except where commercially sensitive) are shown below.

Financial

Financial measures focus on profitability and underlying financial strength:

- **Profit**
  This is our measure of operating result for the business as a whole.

  Operating result: £141.1m

  Progress: ●

- **Liquidity**
  Our liquidity measure sets out our minimum liquidity target for the year in line with the financial plan, and taking into account our regulatory obligations.

  Minimum liquidity level: 107%

  Progress: ●

- **Surplus capital**
  Similarly our surplus capital measure sets out the minimum amount of capital we need to retain, to meet our regulatory obligations and underpin our operational requirements. This minimum is set in line with the financial plan, with due regard for our regulatory requirements.

  Amount of surplus capital: [satisfactory]

  Progress: ●

Customer

Customer measures address the key relationships through which we sustain and grow our business:

- **Customer advocacy**
  We use an external survey to monitor advocacy of customers across the Retail businesses relative to appropriate peers. This gives us our customer advocacy measure.

  Customer advocacy: +10.3%

  Progress: ●

- **Primary current account customers**
  Primary current account customers are defined as those who:

  – Hold one of our standard current accounts.
  – Credit their account with at least £800 per month.

  Primary account customers: 552,000

  Progress: ●

- **Products held per primary current account customer**
  This measure monitors how well we are meeting the needs of our relationship customers (as defined above) by calculating the average number of active products they hold with us.

  Accounts per primary account holder: 2.59

  Progress: ●

To be the UK's most admired Financial Services Business

People

People measures reflect the importance of internal engagement:

- **Colleague engagement**
  Our colleague engagement assessment is derived from our twice yearly internal colleague survey.

  Colleague engagement: 81%

  Progress: ●

Process

Process measures focus on the efficiency of our business in delivering services to our customers:

- **Cost**
  This measure focuses on the cost base for the combined Banking Group as a percentage of its income.

  Cost income ratio: 66.2%

  Progress: ●

- **Compliance with risk appetite**
  We track this measure using key risk criteria across the business. Success means no material breaches against any of these criteria.

  Compliance with risk appetite: 100%

  Progress: ●

● On target
○ Good progress
○ Below target

Visit us online
To find out more about us, visit our website – **www.co-operativebank.co.uk**

Chair's statement

A year ago, in my first statement as Chair of The Co-operative Bank, I described this as one of the most exciting times in our history, and the last 12 months have certainly been eventful. As the UK economy continues to struggle, our member led ownership model has attracted supporters beyond our loyal customer base, while the Financial Times has recognised us as Europe's most sustainable bank for the second year running.

As a co-operative business it is our goal to present customers with a 'compelling co-operative alternative' to the dominance of the shareholder owned banks. The International Year of the Co-operative is a real opportunity to present the co-operative business model to a wider consumer public. But what does the phrase 'compelling co-operative alternative' actually mean?

As a 'co-operative' we are member led rather than shareholder led. This model allows us to focus on the 'bigger picture' rather than react to short term trends. It encourages prudent stewardship, customer focus and a responsible approach to growth.

Our co-operative model also means that we are grounded in our communities. Customers can choose to share in our profits and play a part in how we are governed. This places power in the hands of real people, sitting on area committees, regional and business boards and the Group board itself. What is more, we judge our success by what we put back into local communities, not simply what we earn from them.

As consumers look increasingly to their financial service providers for support, our member led, community focused approach is an increasingly attractive alternative to the shareholder banks. We have supported small and medium businesses through these testing times as part of our overall £1.2bn loans to business during 2011; and we have also reached out to communities who have felt abandoned by other banks.

A particular example of this presented itself in the town of Horbury. Early in 2011, Horbury lost its last remaining bank branch. Co-operative members in the town wrote to us to ask if we could step in and provide a vital service to the community. In June 2011 we opened a new branch in the local Co-operative food store, and the feedback from customers, townspeople and local politicians alike has been positive and customers have voted with their feet. Business is brisk and the Horbury branch is already operating beyond expectations as well as supporting the local community.

One thing our customers most definitely expect from us is a willingness to accept when we have got it wrong. Our figures for 2011 include a provision of £90.0m for historic mis-selling of Payment Protection Insurance (PPI). Although this was an industry wide issue (and our provision is low by comparison with the market leaders) we are committed to identifying where our customers have been disadvantaged and putting things right. We will deal with their complaints in a fair, personal, easy and responsible manner; and we will make sure that we learn from past mistakes.

So does that make us a compelling prospect? We enjoy excellent customer satisfaction and have attracted a steady flow of customers switching to us over the past two years. However we recognise that to become a compelling alternative to the 'Big Five', we need to continue to grow further and increase our scale and presence.

The need to become a compelling co-operative alternative was a driving force behind our merger with Britannia Building Society, and is the basis for our interest in the 632 branches being sold by Lloyds Banking Group. We will not, however, sacrifice our members' interests on the altar of ambition, but continue to examine cautiously the opportunity for us to enhance our reach, grow our customer base and become a truly compelling alternative for the UK consumer.

Another exciting opportunity to increase our reach is through the existing membership and customer base of The Co-operative Group. Last year the Group launched Project Unity to rationalise its operating structure and deliver a more integrated service proposition to its members and its significant customer base. For us, as for the other Co-operative businesses, the opportunities offered by Unity are significant.

In the short term, Unity means restructuring and eliminating duplication, reducing unnecessary cost while reinvigorating the way we work. In the longer term, a truly unified Group offers the advantages of scale, diversity and brand strength, that our strategy demands.

2011 has seen some changes to the leadership of the Bank. Our Chief Executive Officer, Neville Richardson, left the business in July. I would like to thank Neville for his leadership, both at Britannia and during the process of integration with The Co-operative Bank.

Barry Tootell, Chief Financial Officer, has been appointed acting CEO. Barry was an integral part of the executive team that created our vision and is ideally qualified to step seamlessly into the role of guiding the business forward. James Mack, formerly Director of Financial Control, has been appointed acting CFO.

Meanwhile Project Unity has seen a rationalisation of both the executive structure and board composition. Tim Franklin, Chief Operating Officer, and Karen Moir, Director of Organisational Development, have left the business, and I would like to thank both Tim and Karen for their support and commitment in helping to merge two businesses into a single strategic, cultural and operational entity.

In line with the Group structure, we have also slimmed down our board. I would like to express my thanks to the following board members who stepped down in 2011; Chris Jones, Stephen Kingsley, Steve Watts and Piers Williamson. We also reduced the number of executive directors on the Board with Phil Lee, Rod Bulmer and Tim Franklin stepping down.

At the same time, we welcomed two new non-executive directors to the Board, Anne Gunther and Merlyn Lowther. As Chief Executive of the Norwich and Peterborough Building Society, Anne guided the business through its merger with the Yorkshire Building Society. Merlyn is a non-executive director of Schroders plc and a former Chief Cashier of the Bank of England.

In my role as Chair I am responsible for ensuring that the Board operates effectively. This involves putting in place a sound framework in which the Board can make strategic decisions, within a governance structure appropriate to the business of The Co-operative Bank plc. More details on the governance structure and arrangement can be found at page 11.

The phrase 'change is a constant' has become a cliché, but one look at the economy as it stands demonstrates the need for change. It is impossible to grow and develop, to stay in touch with one's customers and markets, without embracing the challenge of change, and we have shown ourselves more than ready to do so. However, the compelling co-operative alternative is built on the same values that inspired the Rochdale Pioneers 168 years ago – voluntary and open membership; democratic control; economic participation; autonomy and independence; education and development; and concern for our community. It is the resonance of those values with customers and investors alike that underpins our ambition to become a real force in UK financial services.

Paul Flowers, Chair

Chief Executive's overview

Welcome to The Co-operative Bank report and accounts for 2011, my first as Chief Executive Officer. It is with pride that I present our results for what has been a successful year in a challenging market.

While the UK economy has shown some signs of stabilisation, commentators and customers alike are anxious about the future. Growth estimates have been downgraded, sovereign debt remains a major issue and the ongoing eurozone crisis continues to suppress market confidence.

As families cope with rising costs, low pay and the government's austerity measures, the Institute for Fiscal Studies reports that living standards have gone into their most significant fall in 25 years. Now more than ever, UK consumers are looking to financial services providers for understanding and support.

As we continue to build the 'compelling co-operative alternative' we continued to invest heavily throughout 2011 in making life easier for our customers and their communities, while maintaining the underlying financial strength to safeguard their investment in us. In supporting UK customers and businesses alike, we have lent £1.2bn to UK businesses and £0.9bn to mortgage customers. Yet continuing our prudent approach to banking, and not over-committing ourselves, we have strengthened still further our loans to deposits ratio which is now 94% (compared with 102% in 2010).

We have taken a significant step forward in the integration of our banking proposition with the extension of full personal banking facilities to our Britannia branch network, which has in effect opened up 245 new bank branches. In doing the right thing for our customers, we aim to build long term relationships, and these in turn will lay the foundations for sustainable success.

This year's results in context

Despite the gloom and uncertainty of the market, our operating profit of £141.1m has remained stable compared with 2010, while the statutory profit of £54.2m (2010: £48.9m) represents a solid performance by the business.

Underpinning these figures is a healthy balance sheet with our core tier one capital ratio robust and stable at 9.6% (unchanged on 2010). Our underlying capital position continues to be a source of strength, and reflects our prudent approach to the stewardship of our customers' money, while our commitment to liquidity has been reflected in the high liability balances retained, including healthy levels of term deposits.

We have successfully raised term funding this year, in residential mortgage backed securities and covered bonds, to support our plans for long term growth. In each case important funds were secured at competitive rates, having been significantly over subscribed. In a year when the Financial Times named us Europe's most sustainable bank for the second year running, our successful dealings in the City underline the confidence of the financial markets in our sustainable business model.

Customers and commentators have again endorsed The Co-operative Bank with numerous awards, including 'best packaged current account' at the Moneynet Personal Finances awards, and 'best longer term fixed rate mortgage provider' according to Moneyfacts. The Bank was also successful in multiple categories at the Moneywise Customer Service Awards.

Our corporate and business banking arm has experienced increases in impairment on corporate lending in line with the market, but the business has shown encouraging growth, laying the groundwork for future success.

A model for sustainable growth

These results reflect the excellent relationships we have with our customers, with customer advocacy levels for 2011 on average 10.3% ahead of our target peer group. They also reflect our determination to challenge ourselves and build for sustainable success. Even as we continue to challenge the cost base throughout the business, we are investing significantly in infrastructure for the future. Our transformation programme is designed to enhance our customer centred banking operations and provide the infrastructure for future growth. The launch of a new bancassurance proposition, in partnership with AXA Wealth, enables us to offer our customers a simplified savings and investments portfolio, while a pilot to offer legal services through 30 branches has been successful. With negotiations at an advanced stage to buy 632 Lloyds TSB branches, the opportunities for growth are exciting, but even without this boost we are confident we have the capacity to increase our scale, reach and presence in the coming years.

Opportunities and challenges in the next 12 months

The year ahead presents a number of significant opportunities and challenges, which will shape the long term future of The Co-operative Bank and its parent company The Co-operative Banking Group.

One of the principal challenges remains the economic climate, which will continue to put pressure on UK businesses and consumers alike. Interest margins are likely to remain low while customer behaviour, in the wake of falling real living standards, will continue to be cautious. Against this background The Co-operative Bank aims to drive down cost in the business, but we will also be taking proactive steps to develop our customer relationship model, focusing on attracting, engaging, deepening and retaining customer relationships.

Within the business, our transformation programme remains a significant investment in the future. At the same time the focus for our customer facing colleagues will be to continue to deliver market leading customer satisfaction.

The decision by Lloyds Banking Group to enter into exclusive negotiations with The Co-operative Bank, over the sale of their 632 branches, reinforces our credentials as a genuine challenger in the UK market. This opportunity complements our strategic vision while offering an excellent chance to achieve real scale on the high street.

We continue to assess the complex nature of this transaction and are diligently assessing the risks and the steps to mitigate them. We are clear that we will only make the acquisition on terms that make sense for our customers and our members.

Project Unity offers a significant opportunity during the coming year and beyond, opening up greater synergies and product development opportunities across The Co-operative Group's family of businesses. The project began to roll out in Quarter 4, 2011 and is due for completion by the end of 2012. Unity offers huge potential, both for customers and for the business itself.

Outlook for the future

If ever there was a time for realism in banking, this is that time. Our industry, and more importantly our customers, face challenges not seen for decades. At The Co-operative Bank we have benefited from sensible, customer centred stewardship during the 'good times' and as a result we are in a position to invest for a better future, while continuing to deliver much needed support to our customers today.

We believe the Co-operative model has never been more relevant, and we believe it is a model for the future. With the increasingly close support of our colleagues across The Co-operative Group, we aim to build on our customer relationships to add value, both to customers and to members. It is this added value that will make us the compelling co-operative alternative.

Barry Tootell, Acting Chief Executive

Business and financial review

Overview

2011 has been a difficult year for the financial sector. Markets remain challenging and unpredictable, while the ongoing eurozone crisis continues to dampen confidence and inhibit growth. The industry continues to suffer from constrained capital markets, squeezed margins and a lack of customer confidence. Meanwhile the long term outlook remains unclear.

Against such a background, the continued resilience of The Co-operative Bank ('the Bank') is a positive endorsement for the Co-operative model. The Bank has provided a safe haven for our customers, fostering long term relationships and building a compelling co-operative alternative within the financial services industry. The steady operating result of £141.1m (2010: £144.5m) for the year reflected a strong performance in the Retail sector, partly offset by a difficult year for the Corporate sector. The income statement also benefited from gains on the sale of Treasury assets of £37.2m (2010: £11.4m) (a result of reshaping our liquidity portfolio), and a reduction in total credit risk expected over the life of the Optimum mortgage book of £20m (2010: £15m). These offset the cost of funding significantly higher levels of liquidity than experienced in 2010, as we continued to strengthen our liquidity, a core element of our financial strength. Statutory profit before tax of £54.2m was generated for 2011 (2010: £48.9m), which was adversely impacted by a provision for payment protection insurance (PPI) mis-selling of £90.0m (2010: £4.3m). Despite the difficulties within the UK economy, asset quality has been maintained with our levels of late residential mortgage arrears (>2.5% of balance) now standing at 1.18%, 0.24% better than the CML industry average for the fourth quarter of 2011.

The foundation of our balance sheet is our sound liquidity position, with an improved loans to deposits ratio of 93.9% (2010: 102.5%), now our primary measure of liquidity and replacing the customer funding ratio, which was 117.6% at the end of 2011 (2010: 106.7%). The Bank has remained active in the wholesale funding markets during the year, raising funding through the securitisation of mortgages and issuance of a covered bond. Furthermore, we have been proactive in managing exposure to the eurozone counterparties. The capital position remains robust, with a core tier one ratio of 9.6%.

Our balanced scorecard approach takes a holistic view of performance, taking into account not just profit generation but effective risk and process management, and our impact on colleagues and customers.

As a member owned bank, our customers trust us to put them at the heart of our business and, by really understanding their needs, we offer products and services tailored to them. As a result, our levels of customer advocacy continue to be strong – for 2011, advocacy for The Co-operative Banking Group was 10.3 percentage points above the average of our top five competitors.

Integration and transformation

Over two years have now passed since the merger with Britannia Building Society. During this time we have integrated the merged operations and are making good progress in transforming the business and realising the benefits of the merger.

Within months of the merger, customers were able to open current accounts in the 245 Britannia branded branches – to date, over 62,000 current accounts have been opened via these branches (nearly 45,000 during 2011). August 2011 saw the introduction of the capability for customers to service current accounts in Britannia branded branches. This effectively extended our banking network from around 90 to over 340 sites and enabled us to rebrand our Britannia branches as part of The Co-operative Bank. We have also continued to attract customers switching their main current account, with a 10.8% year on year increase in 2011 of customers making us their main bank.

To bring colleagues together, we have completed our organisational design and introduced a single set of terms and conditions of employment across The Co-operative Banking Group, with the full support of our recognised trades unions. Despite the pace of change in the business, colleague engagement has increased during 2011, rising to 81% in November 2011 for The Co-operative Banking Group (November 2010: 78%).

Full transformation will be achieved when we have enabled our customer relationship model and provided a platform for growth, through the replacement of our legacy banking systems and infrastructure with modern, flexible solutions. 2011 has seen investment in some very large elements of this programme:

- a new Financial Crime Management system
- an upgrade to our banking mainframe
- a new flexible and functionally rich telephony system
- a new platform for our credit card system
- the first phase of our new payments hub
- the first stage in the re-platforming of our core banking systems

This is just part of our transformation plan, under which we are making a significant investment in our people, processes and systems in order to transform our business for our customers. Other examples of this transformation include the in-store banking programme, which has created new in-store pilot facilities in our food stores in 2011 and aims to increase this still further during 2012.

Project Unity is a Co-operative Group programme seeking to maximise the customer and commercial benefits of belonging to the world's largest consumer co-operative, and The Co-operative Banking Group is a key participant in the project. At the beginning of this year, a new group senior management structure was announced, reinforcing the common culture, purpose and strategic goals that unite our family of businesses and the project began to roll out in depth in 2011. The Co-operative Banking Group now benefits from the economies of scale arising from a single procurement function, with further efficiency gains to be delivered as more enterprise functions are managed on a group basis.

Highlights

Operating result and profit before taxation and distributions	**2011 £m**	2010 £m	Change £m	Change %
Income	**817.6**	821.8	(4.2)	(0.5)
Operating costs – steady state	**(548.2)**	(555.5)	7.3	1.3
Operating costs – strategic initiatives	**(13.4)**	(26.0)	12.6	48.5
Impairment losses	**(114.9)**	(95.8)	(19.1)	(19.9)
Operating result	**141.1**	144.5	(3.4)	(2.4)
Significant items	**(53.3)**	(55.5)	2.2	4.0
Payment protection insurance (PPI) provision	**(90.0)**	(4.3)	(85.7)	n/a
Share of post-tax profits/(losses) from joint ventures	**0.2**	0.7	(0.5)	(71.4)
Financial Services Compensation Scheme (FSCS) levies	**(14.5)**	(11.5)	(3.0)	(26.1)
Fair value amortisation	**86.3**	(14.2)	100.5	707.7
Profit before taxation and distributions	**69.8**	59.7	10.1	16.9
Membership dividend	**(15.6)**	(10.8)	(4.8)	(44.4)
Profit before taxation	**54.2**	48.9	5.3	10.8

Business and financial review continued

The operating result was slightly below 2010, a resilient performance given the difficult market conditions. The profit before tax and distributions of £69.8m was adversely impacted by a provision for PPI mis-selling of £90.0m (2010: £4.3m). Although this is an industry wide issue, as a member owned organisation, we are committed to doing the right thing for our customers, especially if we get things wrong. We will deal with their complaints in a fair, personal, easy and responsible manner.

Profit before tax and distributions of £69.8m (2010: £59.7m) was also after a credit of £86.3m (2010: charge of £14.2m) for the amortisation of fair values. These fair value adjustments principally relate to the amortisation through net interest income of interest rate related adjustments required to be made to the carrying value of assets and liabilities at the time of merger. The credit for the year was adversely impacted by £75m amortisation on various funding instruments caused by an acceleration in their expected redemption. This was offset by the release of contingent merger consideration through operating expenses of £37m no longer expected to be paid.

Profit before tax increased by 10.8% to £54.2m for 2011.

2011 income levels (excluding fair value adjustments) were marginally down on 2010, and reflected the impact of additional funding raised within the past 12 months, lower asset yields and lower investment income, although this was partly mitigated by gains on Treasury asset sales during the year. Income benefited from the reduction in total credit risk expected over the life of the Optimum mortgage book of £20m (2010: £15m).

Operating costs (excluding fair value adjustments and strategic investment costs) have reduced from £555.5m in 2010 to £548.2m in 2011, despite inflationary pressures on the cost base. However, there is further work to do in this area and we remain committed to further improving the cost position over the medium term.

Impairment losses have reflected the difficult economic conditions in 2011, rising by 19.9% compared with 2010 levels, predominantly due to a higher corporate impairment charge. The total charge benefited from the mitigating impact of prudent credit fair value adjustments taken at the time of merger. The residential mortgage book (both Retail and Optimum) continued to perform well and arrears reduced further during 2011, with late mortgage arrears (>2.5% of balance) down from 1.67% at December 2010 to 1.18% at December 2011.

Significant items of £53.3m (2010: £55.5m) were incurred during the year, primarily associated with the investment in our transformation and integration programme.

The 2011 charge for profit distributions to individual members of The Co-operative Group, which are based on their account holdings with the Bank, totalled £15.6m.

Given the economic backdrop and regulatory requirements to hold higher levels of capital and liquidity, as well as consumer behaviour in respect of unsecured lending, the size of the Retail loan book reduced from £17.3bn to £16.2bn over the year, partially compensated for by growth in the Corporate and Platform loan books.

The loans to deposits ratio of 93.9% improved by 8% from the equivalent position at the end of December 2010 (102.5%). The Bank has remained active in the capital markets, completing its second prime mortgage securitisation since the merger and issuing a covered bond. We also undertook a lower tier two exchange into new securities at an on-market rate.

Capital has been carefully managed to maintain the Bank core tier one capital ratio at 2010 levels (9.6%), despite the impact of the PPI provision. The total capital ratio was 14.7% (2010: 14.0%), with a tier one ratio of 9.9% (2010: 9.9%). During the year, a capital injection was made to the Bank of £87m, from The Co-operative Banking Group.

Our businesses

Operating result	2011 £m	2010 £m	Change £m	Change %
Retail	**94.6**	47.4	47.2	99.6
CABB	**14.5**	54.7	(40.2)	(73.5)
Other	**32.0**	42.4	(10.4)	(24.5)
Operating result	**141.1**	144.5	(3.4)	(2.4)

The Bank consists of two primary operating segments – Retail, and Corporate and Business Banking (CABB).

The Retail business (trading as The Co-operative Bank, Britannia and **smile**) offers a range of financial products and services to individuals and households throughout the UK.

CABB includes corporate banking, business banking, business services, Platform (the intermediary mortgage business) and Optimum (the closed book of pre-merger intermediary and acquired loan book assets). CABB effectively incorporates all the key business to business elements of the Bank.

Included in the Other segment are the results of the Treasury activities of the business. Also included are the results of Unity Trust Bank.

During 2011 the Bank's internal reporting structure was revised, to include Optimum within CABB; this was previously reported separately. The 2010 results reported above have been revised to reflect this change.

Retail

Retail operating result	2011 £m	2010 £m	Change £m	Change %
Net interest income	**387.4**	389.1	(1.7)	(0.4)
Non-interest income	**150.2**	147.2	3.0	2.0
Net income	**537.6**	536.3	1.3	0.2
Operating costs – steady state	**(399.3)**	(406.2)	6.9	1.7
Operating costs – strategic initiatives	**(9.4)**	(19.9)	10.5	52.8
Impairment losses	**(34.3)**	(62.8)	28.5	45.4
Operating result	**94.6**	47.4	47.2	99.6

The Retail operating result for 2011 of £94.6m was nearly double that of 2010 (£47.4m).

Mortgage income has improved largely as a result of new business and retention of maturing balances at higher margins. However, this has been offset by lower net interest income both on deposit balances and credit cards. The cost of maintaining high liability balances reflects our commitment to maintaining a sound liquidity position. Lower credit card balances and yields reflect the change in customer behaviour to pay down unsecured debt due to the difficult economic conditions.

Non-interest income was better than last year due to higher current account balances, and the rollout of 280 additional ATM installations in Co-operative food stores.

Building the compelling co-operative alternative

Impairment losses were significantly lower in 2011 than in 2010, by 45.4%. Key drivers include declining credit card balances and improvements in the collection of arrears. Mortgage quality has been maintained with continued low rates of impairment.

Our focus continues to be on delivering high quality assets with the average loan to value remaining at below 50% across the Retail business, in line with 2010.

The strength of the Retail customer proposition continues to be recognised by a range of awards. In 2011 the Bank won Moneysupermarket's 'Best Current Account Provider 2011', received the 'Best Longer Term Fixed Rate Mortgage Product' award from Moneyfacts, and was successful in several categories at the Moneywise Customer Service Awards. The Bank's credibility amongst customers and commentators alike was underscored by a second year of being shortlisted for 'Best Financial Services Provider' at the 2011 Which? Awards.

Corporate and Business Banking

CABB operating result	**2011 £m**	2010 £m	Change £m	Change %
Net interest income	**161.5**	146.4	15.1	10.3
Non-interest income	**68.2**	66.2	2.0	3.0
Net income	**229.7**	212.6	17.1	8.0
Operating costs – steady state	**(127.4)**	(123.1)	(4.3)	(3.5)
Operating costs – strategic initiatives	**(3.2)**	(4.8)	1.6	33.3
Impairment losses	**(84.6)**	(30.0)	(54.6)	(182.0)
Operating result	**14.5**	54.7	(40.2)	(73.5)

The CABB operating result for 2011 was £14.5m (2010: £54.7m).

Corporate banking

Corporate banking has delivered an operating loss of £36.4m during 2011 (2010: profit of £2.5m). This reflects another difficult year for the industry, with impairment losses rising from £31.4m to £87.4m, including a collective provision against potential losses of £10.4m. There has been measured growth of Corporate banking assets through selected high quality new business, combined with continued significant liability growth through term deposits (c. 43% growth in corporate deposits during 2011, evidencing the appeal of our proposition to the market), leading to higher net interest income.

Corporate banking rolled out a further two Corporate banking centres during 2011, taking the total number to 22. Alongside our specialist sector and customer deposits teams, these will be used to drive measured balance sheet growth.

Platform

The Platform intermediary mortgage business, focusing on the prime mortgage and buy to let markets, has continued to grow in the marketplace throughout 2011. The focus for Platform remains on good quality prudent lending and advances of £0.6bn have been extended during 2011 with strong margins achieved and late arrears (>2.5% of balance) on only 0.30% of accounts (2010: 0.71%).

Optimum

In 2011 the Optimum portfolio, a closed book of intermediary and acquired mortgage book assets, reduced in size, as planned, by 5.5% to £7.7bn, and delivered a profit of £52.7m (2010: £61.2m).

Throughout the year, the business has continued to deliver improvements in its management of arrears, with a focus both on existing and pre-arrears cases. As a result, arrears in Optimum have continued to improve steadily, and the business has been able to release £20m (2010: £15m) of its total provision for credit risk expected over the life of the Optimum mortgage book. The remaining merger related fair value provisions against the portfolio continue to provide a high degree of cover against credit losses.

Other businesses

The main component of the Other business segment, our Treasury operation, has continued to deliver on its core responsibilities of ensuring a stable liquidity base, providing diverse sources of wholesale funding to the Bank, managing market risk and delivering a favourable financial performance on the investment portfolio. The Treasury result benefited from gains on the sale of Treasury assets of £37.2m (2010: £11.4m) as part of reshaping the investment portfolio. However, it was impacted by a challenging funding environment driven by uncertainty in the financial markets, especially in the eurozone, with margins continuing to be under pressure during the year. Net interest income was negatively impacted by increased investment in highly liquid, low risk assets as well as the reduction in higher risk and higher earning investment assets together with increased structured funding transactions.

The Bank has no sovereign exposure to 'peripheral' eurozone countries (namely Portugal, Ireland, Italy, Greece and Spain), and no exposure to Greek financial institutions or any other Greek counterparties. Other peripheral eurozone country and counterparty limits have continued to be cautiously managed downwards, and exposure is primarily restricted to short dated money market lending. Investment assets in peripheral eurozone counterparts are in run-off, with associated counterparty and country limits reducing upon maturity or sale. The Treasury investment assets maturing over the coming year amount to £539m (16% of the investment portfolio). Further detail is included in the Risk Management section.

Outlook

The Bank has been granted preferred bidder status by Lloyds Banking Group in the process currently being run for the sale of its 632 branches. This is part of our ambition to build upon our strong foundations in banking, to ensure customers have a genuine alternative on the high street. The combination of the Lloyds Banking Group branches and our own branch network is consistent with our strategy to strengthen our position as a real challenger in relationship banking in the UK. Our current bid is non-binding and we would only proceed if we could reach an agreement that was in the interests of our members and other stakeholders. Any transaction would be subject to regulatory approval.

Given the considerable scale, reach and reputation of the wider Co-operative Group, Project Unity will open up many potential synergies and product development opportunities, which will considerably enhance both the financial strength of the business and the experience for our customers.

The outlook for the financial services industry remains difficult, and latest indications point to a continuation of these challenging circumstances, particularly in the Corporate sector. Together with increasing regulatory requirements, these will continue to weigh heavily on earnings. Our focus remains on ensuring our continued financial resilience, and means that we can look forward with optimism and confidence to the future.

Social goals

Introduction
In the midst of the current global economic challenges, and with increasing calls for more ethical and responsible forms of business, it is appropriate that the United Nations should herald 2012 as the International Year of Co-operatives. The Co-operative model is being seen as an increasingly relevant factor to a more balanced, sustainable economy.

The Co-operative Bank has been at the forefront of this renaissance. Our reputation amongst consumers (who consistently see us as the UK's most socially responsible bank), remains unparalleled. Also in 2011, the Financial Times and the International Finance Corporation recognised us as Europe's most sustainable bank – the second successive year that our commitment to social responsibility has been recognised in this way.

In 2011, our approach to sustainability was revitalised with the launch of The Co-operative Ethical Plan. The Plan, to be refreshed each year in consultation with our democratically elected member representatives, sets ambitious targets across issues of primary concern for members.

Whilst challenges remain, we believe our business model will thrive by delivering value to our members and customers in a responsible and sustainable manner.

Materiality, strategy and governance
The Co-operative Bank has always had a purpose beyond profit. As part of The Co-operative Group, we are owned by our members and accountable to them through our democratic structure. The Group Values and Principles Committee, made up of elected members, oversees our sustainability strategy and customers and members help shape our unique Ethical Policy.

The Group's Ethical Plan sets out targets across eight priority areas. We review these annually with our members through the Group Values and Principles Committee to ensure that we continue to show the way forward for corporate sustainable development in the UK. Performance is transparently reported in the award winning annual Sustainability Report of our parent company, The Co-operative Group.

Performance overview

Responsible finance
A longstanding focus on responsible finance is firmly embedded in our business. Over the last two decades our unique customer led ethical policy has led to our refusing over £1bn of finance to businesses or projects that failed to satisfy our social or environmental standards. At the same time we have seen our commercial lending grow to £9bn.

Throughout 2011 our Social Banking Unit provided a dedicated resource for social, co-operative and environmental businesses. Around a quarter of all bank lending is channelled into such businesses and has to date contributed £700m of a £1bn commitment to fund green energy and energy efficiency projects. A range of organisations with a social purpose received funding during 2011, including the Youth Hostel Association (£13m) and Social Investment Scotland (£1.5m), an organisation that provides loans for charities and social enterprises unable to secure bank loans. Since 2008, our charity business has doubled, with customer numbers increasing to over 4,800 in 2011.

We believe that responsible finance should mean accessible finance. For a decade, our lending to small businesses in deprived areas, as a proportion of equivalent bank activity, has consistently exceeded the industry average. Our provision of basic bank accounts is up 21% from 2010, and we maintain our support to the pioneering 'bank accounts for prisoners' project, providing those opening an account with a better opportunity to secure housing and employment, factors considered key to reducing reoffending.

Keeping communities thriving
In 2011, The Co-operative family of businesses invested £13.6m in communities at home and around the world, and we are aiming to invest 10% of monies available for distribution by 2013, building on our current support for 10,000 community initiatives each year – one new project every hour, every day.

Colleagues throughout The Co-operative Bank contributed to the £7m raised in 2011 for our Charity of the Year partners, Mencap and sister charity ENABLE in Scotland, to improve the lives of young people with a learning disability around the UK – well above our £5m target.

Our members helped over 2,400 local community groups by donating their share of the profits to The Co-operative Community Fund, and Co-operative Bank colleagues volunteered in a range of community projects.

Supporting co-operatives
We believe in 'co-operation amongst co-operatives', supporting the growth of responsible businesses and contributing to the development of a more diverse and sustainable economy. We continue to be the only bank to offer a current account for credit union members, in partnership with the Association of British Credit Unions Ltd and provide facilities to 60% of the credit union sector.

As part of The Co-operative Group, we are also investing £17m over the next three years to support the growth and development of co-operatives in the UK and overseas. The Co-operative Enterprise Hub continues to provide professional business advice and training to help new co-operatives get off the ground and help existing co-operatives to grow and become more sustainable. Over 700 co-operatives have benefited from the Hub's support to date, helping to contribute to the growth in the UK co-operative sector, which comprises more than 5,000 co-operatives nationwide.

Inspiring young people
The Co-operative Group's Inspiring Young People programme aims to bring about a cultural shift in the way that young people are viewed and treated in the UK, and to help them change their world. The programme aims to have benefited one million young people by 2014.

Our Skills for Schools programme, delivered by colleague volunteers, aims to improve the financial literacy, numeracy and employability of school children. Our Green Schools Revolution, launched in September 2011, is a new sustainability education programme for primary and secondary schools. So far, over 3,000 UK schools have registered to take part with a view to engaging 6,000 schools, or one in five across the UK by 2014.

In 2011, The Co-operative Group established a Co-operative Academy school in Leeds, the third Academy to be launched to date, and we aim to establish a total of six by the end of 2013, delivering an innovative curriculum within a values led ethos. This forms part of the Group's wider work supporting Co-operative Schools, which includes establishing a co-operative society, to which over 200 schools are currently enrolled.

Protecting the environment
Our longstanding commitment to the environment speaks for itself. In line with our customers' concerns, we have declined almost £500m of finance to businesses or projects that did not meet our environmental standards since the launch of our Ethical Policy, whilst providing £700m finance for projects with a positive environmental impact. During 2011, we continued to offset all our carbon dioxide emissions, together with an additional 10% to compensate for our carbon legacy. The Co-operative Group has cut greenhouse gas emissions by 35% since 2006, saving half a million tonnes of greenhouse gases each year and well ahead of its 2017 target. The Group is aiming for a 50% cut in emissions by 2020, and to generate the equivalent of 25% of all electricity used from its own renewable sources by 2017.

In 2011, The Co-operative Bank achieved recertification to the ISO 14001 standard and we are still the only financial services organisation in the world to achieve this leading standard across all business activities and products. Looking forward our state of the art head office, which opens in 2012, will set new standards for the UK in sustainable design, construction and operation.

Tackling global poverty
The Co-operative Group continues to strive for a fairer world, where basic human needs are met and rights respected. We support microfinance institutions in 27 countries across the globe with a $50m fund to provide small loans to people in the world's poorest countries. Our charity credit cards have enabled customers to raise a staggering £729,000 for organisations tackling global poverty and human rights issues, such as Oxfam and Amnesty International.

In 2011, The Co-operative Group entered into a partnership with CARE International UK to support 'lendwithcare.org'. The innovative scheme allows people in the UK to lend directly to entrepreneurs in the developing world, helping them to grow their businesses and ultimately to work their way out of poverty. Our aim is to facilitate 30,000 loans by the end of 2012. The Co-operative Bank is also spearheading The Global Development Co-operative – a new development fund intended to support co-operatives in the developing world.

2012 promises to be another challenging but rewarding year. The Co-operative business model will be brought to the fore through the UN International Year of Co-operatives, while our groundbreaking Ethical Plan will help us in our ambition to remain the UK's most socially responsible business and at the same time, inspire more people than ever to change their world.

The Board

Non-executive directors:

Paul Flowers (BA (Hons))
Age 61. Joined the Board in 2009 and appointed Chair in 2010. Deputy Chair of Co-operative Group Limited. Superintendent Methodist Minister. Member of The Co-operative Group North Regional Board. Non-executive director of Co-operative Banking Group Limited, Co-operative Insurance Society Limited and CIS General Insurance Limited.

Rodney Baker-Bates (MA, FCA, AIMC, FCIB)
Age 67. Joined the Board in 2009 and appointed Deputy Chair in 2010. Chair of Willis Limited. Directorships also held at Bedlam Asset Management plc, Dolphin Square Trust Limited, EG Solutions plc, G's Group Holding Limited and Stobart Group plc. Non-executive director of Co-operative Banking Group Limited, Co-operative Insurance Society Limited and CIS General Insurance Limited.

Duncan Bowdler (BSc (Hons) Biochemistry)
Age 53. Joined the Board in 2009. Trade and Legislation Manager. Member of The Co-operative Group North West and North Midlands Regional Board. Non-executive director of Co-operative Group Limited, Co-operative Banking Group Limited, Co-operative Insurance Society Limited and CIS General Insurance Limited.

David Davies (BSc (Econ), FIA)
Age 64. Joined the Board in 2003, appointed Deputy Chair in 2010. Qualified actuary. Chair of Sun Life Assurance Company of Canada (UK), the PACE Pension Scheme and Nortel Networks Pension Scheme in the UK. Non-executive director of Interglobal Insurance Company Limited. Non-executive director of Co-operative Banking Group Limited, Co-operative Insurance Society Limited and CIS General Insurance Limited.

Anne Gunther (BSc (Hons), MBA, ACIB, FCIBS)
Age 57. Joined the Board in 2011. A career retail banker, most recently as Chief Executive of Standard Life Bank and then Chief Executive of Norwich and Peterborough Building Society to secure its merger with the Yorkshire Building Society. Chair of Warwick Business School. Non-executive director of Co-operative Banking Group Limited, Co-operative Insurance Society Limited and CIS General Insurance Limited.

Peter Harvey (ACIB, Dip FS)
Age 56. Joined the Board in 2009. Consultant to Berwin Leighton Paisner LLP and non-executive director of Marshalls Holdings Limited. Non-executive director of Co-operative Banking Group Limited, Co-operative Insurance Society Limited and CIS General Insurance Limited.

Paul Hewitt (MA, ACA, Dip German (Open))
Age 56. Joined the Board in 2003. Chair of RJ Kiln & Co Limited, The Good Care Group Limited and Four Times Enterprises Limited. Non-executive director of Shop Direct Financial Services Limited, trustee member of NEST (the National Employment Savings Trust) and Industrial partner with Lyceum Capital, a mid market private equity firm. Non-executive director of Co-operative Banking Group Limited, Co-operative Insurance Society Limited and CIS General Insurance Limited.

Merlyn Lowther (BSc (Hons), MBA, FCIB)
Age 58. Joined the Board in 2011. Chief Cashier of the Bank of England from 1999 to 2004. Non-executive director of Schroders plc. Trustee of the Winston Churchill Memorial Trust and The Henry Smith Charity. Non-executive director of Co-operative Banking Group Limited, Co-operative Insurance Society Limited and CIS General Insurance Limited.

Peter Marks
Age 62. Joined the Board in 2009. Group Chief Executive of Co-operative Group Limited. Named Orange Leader of the Year 2009 in the National Business Awards. Entire working life spent within the Co-operative Movement. Instrumental in bringing about a number of major co-operative mergers over the past decade, as well as the Group's acquisition of the Somerfield supermarket chain. Non-executive director of Thomas Cook Group plc. Non-executive director of Co-operative Banking Group Limited, Co-operative Insurance Society Limited and CIS General Insurance Limited.

Bob Newton (BSc, FIA, CDir)
Age 62. Joined the Board in 2007. Retired from the insurance industry in 2006 and has since built a portfolio of business and pro bono interests. Chair of Silentair Group Limited. Non-executive director of UIA (Insurance) Limited and Reclaim Fund Limited. Non-executive director of Co-operative Banking Group Limited, Co-operative Insurance Society Limited and CIS General Insurance Limited.

Ben Reid OBE (FCCA)
Age 57. Joined the Board in 2009. Chief Executive of The Midcounties Co-operative and also Chair of Walsall Healthcare NHS Trust. Non-executive director of Co-operative Group Limited, Co-operative Banking Group Limited, Co-operative Insurance Society Limited and CIS General Insurance Limited.

Len Wardle (BA)
Age 67. Joined the Board in 2002. Chair of Co-operative Group Limited and member of the South East Regional Board. Held management positions in local government and latterly was a Fellow at the University of Surrey in the School of Management. Director of Communicate Mutuality Limited. Non-executive director of Co-operative Banking Group Limited, Co-operative Insurance Society Limited and CIS General Insurance Limited.

Martyn Wates (ACA, ATII, BA (Hons))
Age 45. Joined the Board in 2007. Has held various senior finance positions within the co-operative movement. Director of various internal subsidiaries and non-executive director of Co-operative Banking Group Limited, Co-operative Insurance Society Limited and CIS General Insurance Limited.

Executive Director:

Barry Tootell (BA (Hons), FCA)
Age 50. Joined the Board in 2008. Acting Chief Executive Officer. Qualified accountant with over 20 years of banking experience and was previously Chief Financial Officer. Executive director of Co-operative Banking Group Limited, Co-operative Insurance Society Limited and CIS General Insurance Limited.

Report of the Board of Directors

Introduction
The Co-operative Bank plc (the Bank) is a subsidiary of The Co-operative Banking Group (the Banking Group) and its ultimate parent company is Co-operative Group Limited (Co-operative Group) which is an Industrial and Provident Society that is jointly owned and democratically controlled by its members.

During the year, a number of actions were undertaken to enhance further the governance structure of the Board and bring it in line with evolving best practice. These included changes to the composition of the Board with a reduction in numbers of members whilst at the same time increasing the diversity of the Board.

During the year, with the exception of the level of independent representation on the Board and Audit Committee, the Bank believes it has fully complied with the principles and provisions of the UK Corporate Governance Code (the Code) appropriate to the democratic structures of the Bank and its parent organisations; the Banking Group and Co-operative Group. The Bank has also continued to consider and address the final recommendations arising from the introduction of the Code. In particular, a detailed review of the risk management framework in which the Bank operates has taken place and the Board and Board committees have redefined membership, responsibilities and terms of reference.

The corporate governance section of the Directors' report describes the key governance mechanisms operating within the Bank and Banking Group.

Board composition and independence
The names of the current members of the Board, their biographies and details of length of service are set out on page 10.

The size and composition of the Board was reviewed in 2011 in light of an external evaluation of the Board's effectiveness in 2010 and introduction of the Code. The aim of the review was to increase both the independence of the Board and its effectiveness. The opportunity was also taken to introduce new talent into the Board (within the reduced Board size) and improve its diversity in line with the recommendations made in Lord Davies' review into Women on Boards. The review led to several directors stepping down from the Board with a reduction in overall numbers on the Board. The changes to the Board composition and independence which stem from the review have meant that by the end of the year the Board was compliant with the Code.

The Bank Board consists of 13 non-executive directors and two executive directors. Of the 13 non-executive directors four are members of The Co-operative Group Board, two are Co-operative Group Executives and seven are externally recruited for their specific financial services experience and expertise.

The two executive directorships are held by the Chief Executive and the Chief Financial Officer of the Bank who also hold the same role in the wider Banking Group. In July 2011 Neville Richardson stepped down from his position as Chief Executive of the Banking Group and its subsidiaries (including the Bank) and Barry Tootell (Chief Financial Officer and an executive director) was appointed as Acting Chief Executive. The position of Chief Executive has not, as yet, been appointed on a permanent basis and evaluation and interviews by the Board for this permanent appointment are ongoing. James Mack was appointed Acting Chief Financial Officer but is currently not an executive director and therefore there is a vacancy on the Board.

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 judgment and whether there are any relationships or circumstances which are likely to affect, or could appear to affect, the director's judgment.

The Board has concluded that, looking across the wider Co-operative Group, the individual members elected by and from The Co-operative Group's seven regions to stand as directors (unless employees within the last five years) should be defined as independent, while those appointed directors representing independent society members of The Co-operative Group could not be so categorised in the co-operative context. This is because the latter represent significant stakeholders with material business relationships with the Banking Group and Bank.

The Board believes it has sufficient independent representation having seven independent non-executive directors (excluding the Chair). There are six external independent professional non-executive directors: Rodney Baker-Bates, David Davies, Peter Harvey, Bob Newton, Anne Gunther and Merlyn Lowther. Len Wardle has been elected by and from the members of The Co-operative Group and the Board has determined him to be independent.

Ben Reid represents independent society members of The Co-operative Group. Peter Marks and Martyn Wates hold executive appointments in The Co-operative Group (Peter Marks is the Group Chief Executive and Martyn Wates is the Deputy Group Chief Executive). Duncan Bowdler is an employee of The Co-operative Group. Paul Hewitt is an external non-executive director and was, until 28 July 2007, Deputy Chief Executive of Co-operative Group. Barry Tootell is the Acting Chief Executive of the Bank. These directors cannot therefore be considered to be independent.

David Davies and Rodney Baker-Bates are the Deputy Chairs and together fulfil the role of a senior independent director.

All the non-executives 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 judgment, knowledge and experience to the Board's deliberations. The non-executive directors are of sufficient calibre and number that their views carry significant weight in the Board's decision making.

Appointment and reappointment of directors
The directors that serve on the Banking Group Board also sit on the Bank Board to provide common leadership of the financial services business. Appointments to the Banking Group Board are made by The Co-operative Group Board. For the recruitment of external non-executive directors, external recruitment consultants are retained.

All non-executive directors are eligible for re-appointment at the end of each term of office. The Co-operative Group Board, being party to agreements with the independent professional non-executive directors for services to the Banking Group and its subsidiaries, including the Bank, may resolve to re-appoint at or before the date their contracts expire for a further three year term. It is the normal policy of the Board not to allow an independent professional non-executive director to serve for more than nine years in aggregate.

Under the Articles of Association, one third of the Board is required to retire by rotation at the conclusion of the Annual General Meeting (AGM). In accordance with the Articles of Association, therefore, three directors retire by rotation, Paul Flowers, Peter Marks and Paul Hewitt and all offer themselves for re-election at the 2012 AGM. Two directors have been appointed since the conclusion of the last AGM on 12 May 2011 (Anne Gunther and Merlyn Lowther) which makes them eligible for re-appointment at the 2012 AGM and both offer themselves for re-election at the 2012 AGM.

At its meeting on 21 April 2010, The Co-operative Group Board noted the Walker Review recommendations that the Chair should stand for re-election every year. The Banking Group and its subsidiaries including the Bank, considered that this

Report of the Board of Directors continued

course of action was more relevant to organisations where there are a number of shareholders, who had less direct influence on the process of selecting candidates for the Chair. For the Bank, the shareholders are the Banking Group and The Co-operative Group which directly controls the process of appointment. The Chair of the Bank is also the Chair of the Banking Group. As the Chair's performance is evaluated annually, The Co-operative Group Board will be asked to reconfirm the Chair's appointment annually. The Chair still stands for re-election by rotation every three years.

The notice of the AGM can be found on page 124. All directors due for re-election continue to demonstrate commitment to their roles (see schedule of attendance on page 14).

Changes to the Board
The directors of the Bank during the financial year are listed below. They were in office for the full period unless otherwise indicated:

Non-executive directors	Date of appointment	Date of resignation
Paul Flowers (Chair)		
Rodney Baker-Bates		
Duncan Bowdler		
David Davies		
Anne Gunther	6 September 2011	
Peter Harvey		
Paul Hewitt		
Chris Jones		31 August 2011
Stephen Kingsley		16 June 2011
Peter Marks		
Merlyn Lowther	7 September 2011	
Bob Newton		
Ben Reid		
Steve Watts		8 July 2011
Len Wardle		
Martyn Wates		
Piers Williamson		8 September 2011
Executive directors		
Neville Richardson (Chief Executive)		22 July 2011
Rod Bulmer		16 June 2011
Tim Franklin		16 June 2011
Phil Lee		16 June 2011
Barry Tootell (Acting Chief Executive)		

Board diversity
The Bank, as part of the Banking Group, welcomes diversity and actively promotes a policy and practice of equality of opportunity in employment for all colleagues, regardless of age, disability, ethnicity, gender, religion or belief, or sexual orientation.

Of the 13 non-executive directors of the Bank two of these are women. Anne Gunther and Merlyn Lowther were appointed to its Board in 2011 and women now represent 15% of the Board. Any further appointment of directors, will take into consideration the Board's policy on diversity in light of Lord Davies' independent review into Women on Boards and its recommended minimum percentages of women on Boards.

Role and responsibilities of the Board
The Board is responsible for the long term success of the Bank 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 Board is to direct the business of the Bank and in particular to:

- ensure that the Bank's affairs are conducted and managed in accordance with its Articles of Association, the best interests of its stakeholders and 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 annual report, financial statements and dividends;
- monitor, utilising various committees, the key significant risks facing the Bank;
- establish Board committees and agree their terms of reference; and
- approve the delegated financial authorities.

The role of the Chair
The Chair is a non-executive director and 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. The Chair has no involvement in the running of the day to day business of the Bank. The Chair facilitates the effective contribution of directors, constructive relations between the executive and non-executive directors, ensures directors receive accurate, timely and clear information and ensures that there is effective communication with members. During 2011 the Chair undertook one to one discussions with all directors regarding the performance of the Board. There are two Deputy Chairs who support the Chair.

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

The current Chair is Paul Flowers and the two Deputy Chairs are David Davies and Rodney Baker-Bates. Details of the Chair's and Deputy Chairs' professional commitments are included in the biographies on page 10. The Board is satisfied that these responsibilities do not interfere with the performance of the Chair or Deputy Chairs' duties for the Bank.

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 Articles of Association and the schedule of matters reserved to the Board for decision provide that the appointment and removal of the Secretary is a matter for the full Board.

The role of the Chief Executive and the Executive

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.

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 management of the Bank.

How the Board operates

Meetings

The Board meets on a monthly basis and it met 11 times in 2011. There were also two strategy meetings, attended by senior executives, devoted to consideration of performance and longer term planning. The Board is scheduled to meet for 11 Board meetings and to hold two strategy meetings in 2012. In addition, the Board holds private sessions in the absence of executive directors, if appropriate. Details of attendance at Board meetings are noted on page 14.

Board and committee papers are distributed at least eight days 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. As well as circulating papers as hard copies, the Board has access to its own secure website where papers are available together with additional supporting material (and which acts as a library of papers for directors).

In September 2011, The Co-operative Group Board approved the roll out of a secure software application supported via iPad technology to provide access to Board papers. The principal aims are to increase security and to provide a more environmentally friendly solution to the distribution of papers by eliminating hard copy production as far as possible. The intention is to eliminate hard copy distribution by the summer of 2012.

Board committees

With the agreement of the Financial Services Authority (FSA), the Board has delegated certain responsibilities to a number of 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 in ensuring the effectiveness of the Bank and its subsidiaries. A provision of the Code is that the terms of reference for the Remuneration and Appointments Committee and the Audit Committee are available on the Bank's website, and the Bank complies with this.

In 2011, the continuing review of the Banking Group Risk Management Framework progressed. The review made a number of recommendations in light of new regulations and evolving best practice, and these were implemented during 2011 alongside a detailed review of the terms of reference and composition of the committees. As a result of the review, the terms of reference for the key committees, being the Audit Committee, the Exposures Committee and the Risk Committee have been revised.

The revised terms of reference incorporate recommendations contained in the Walker Report, Solvency II, the 2010 external Board Effectiveness Review and the review undertaken by external consultants. All committees meet as a joint committee for the Banking Group, Co-operative Insurance Society Limited (CIS), CIS General Insurance Limited (CISGIL) and the Bank. The terms of reference for all the committees can be found at http://www.co-operativebankinggroup.co.uk.

Remuneration and Appointments Committee

Information on the Remuneration and Appointments Committee is found on page 19.

Audit Committee

The committee comprises five members and is chaired by Paul Hewitt. During the year the committee comprised:

Paul Hewitt	(Chair)
Duncan Bowdler	(appointed 23 November 2011)
Ben Reid	
Bob Newton	
Peter Harvey	(appointed 23 November 2011)
Chris Jones	(resigned 18 August 2011)
Martyn Wates	(resigned 8 September 2011)

Paul Hewitt and Ben Reid bring recent and relevant financial experience and in addition Ben Reid is Chair of The Co-operative Group's Audit and Risk Committee. Duncan Bowdler is also a member of The Co-operative Group's Audit and Risk Committee. Bob Newton and Peter Harvey are considered to be independent members of the committee. The committee's terms of reference and constitution were approved on 13 July 2011. Chris Jones stood down from the committee when he ceased to be a director.

The changes to the committee were to address the lack of independence on the committee and that it did not comply with its terms of reference. The make up of the committee will again be revisited in May 2012. The committee met four times during the financial year. The main responsibilities of the committee are set out in its terms of reference. In the year the committee reviewed its own effectiveness.

Risk Committee

The committee comprises five members and is chaired by Peter Harvey. During the year the committee comprised:

Peter Harvey	(Chair) (appointed 8 September 2011)
David Davies	
Paul Hewitt	
Merlyn Lowther	(appointed 8 September 2011)
Bob Newton	(appointed 8 September 2011)
Piers Williamson	(Chair) (resigned 8 September 2011)
Stephen Kingsley	(resigned 16 June 2011)
Barry Tootell	(resigned 22 July 2011)
Mike Fairbairn	(Chief Risk Officer) (resigned 8 September 2011)

Piers Williamson and Stephen Kingsley stood down from the committee following their resignation as Board members. The committee's terms of reference were approved on 13 July 2011. These stated that the members of the committee should be non-executives directors only, with the majority of these members being independent non-executive directors. For this reason Barry Tootell resigned from the committee in July and Mike Fairbairn resigned in September.

The committee met seven times during the financial year. The main responsibilities of the committee are set out in the terms of reference.

Report of the Board of Directors continued

Exposures Committee
The committee comprises four members and is chaired by Peter Harvey. During the year the committee comprised:

Peter Harvey	(Chair)
Anne Gunther	(appointed 8 September 2011)
Duncan Bowdler	(appointed 8 September 2011)
Len Wardle	(appointed 8 September 2011)
Kevin Blake	(resigned 8 September 2011)
Neville Richardson	(resigned 22 July 2011)
Steve Watts	(resigned 8 July 2011)
Piers Williamson	(resigned 8 September 2011)

The committee met eight times during the financial year. The committee's terms of reference were approved on 13 July 2011. These stated that the members of the committee should be non-executive directors only with the majority of these members being independent non-executive directors. For this reason Kevin Blake resigned from the committee in September. The main responsibilities of the committee are set out in the terms of reference. Steve Watts and Piers Williamson stood down from the committee following their resignations as Board members.

During the year the committee reviewed its own effectiveness.

Transformation Committee
The committee comprises three members and is chaired by Bob Newton. During the year the committee comprised:

Bob Newton	(Chair) (appointed 16 June 2011)
Stephen Kingsley	(resigned 16 June 2011)
Paul Flowers	(appointed 14 July 2011)
Paul Hewitt	

The main responsibilities of the committee are set out in its terms of reference. It looks at integration issues across the Bank and Banking Group.

Stephen Kingsley stood down from the committee at the same time he stood down as a Board director.

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	Bank Board	Audit	Risk	Exposures	Transformation	Remuneration
Number of meetings held	11	4	7	8	11	5
Paul Flowers	11 (11)				2 (3)	5 (5)
Rodney Baker-Bates	10 (11)					5 (5)
Duncan Bowdler	11 (11)			2 (2)		
David Davies	9 (11)		5 (7)			5 (5)
Anne Gunther	3 (3)			2 (2)		
Peter Harvey	10 (11)		2 (2)	7 (8)		
Paul Hewitt	11 (11)	4 (4)	6 (7)		11 (11)	
Stephen Kingsley	6 (6)		2 (3)		7 (7)	
Merlyn Lowther	1 (2)		1 (1)			
Peter Marks	8 (11)					5 (5)
Bob Newton	11 (11)	4 (4)	1 (2)		9 (11)	
Ben Reid	9 (11)	4 (4)				
Barry Tootell	11 (11)		3 (4)			
Len Wardle	11 (11)			2 (2)		5 (5)
Martyn Wates	10 (11)	3 (3)				
Former directors						
Rod Bulmer	6 (6)					
Tim Franklin	6 (6)					
Chris Jones	8 (8)	3 (4)				
Phil Lee	6 (6)					
Neville Richardson	7 (7)			5 (5)		
Steve Watts	7 (7)			4 (4)		
Piers Williamson	7 (7)		5 (5)	6 (6)		

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.

Professional advice and Board support

A number of external consultants provide professional advice to the Board. There is an agreed procedure by which directors may take independent professional advice at the Bank's expense in furtherance of their duties.

Insurance and indemnities

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. This constitutes a 'qualifying third party indemnity provision' for the purposes of Section 236 of the Companies Act 2006 and applied to all of the Bank's directors serving during the financial year. The insurance cover was reviewed and renewed in 2010. The cover will again be renewed in 2012.

In terms of Section 236 of the Companies Act 2006 a 'qualifying pension scheme indemnity provision' was also in place for one or more of the directors who served during the financial year.

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 or the Banking Group or in the Co-operative Group Limited, which is the ultimate holding organisation, or in any other entity controlled by the Co-operative Group Limited.

Conflicts of interests

The Board has considered the current external appointments of all directors which may give rise to a situational conflict and has authorised potential conflicts where appropriate.

Effectiveness

Induction and continuing professional development

In line with recommendations of the Code, the Bank has reviewed the induction programme for new directors and all newly elected directors are required to undertake a structured induction programme. This is designed to include key corporate governance and business information, including briefing sessions with the Executive on the strategy and performance of key business areas.

A Board learning and development policy is in place to support all non-executive directors. Following meetings with non-executive directors to review individual and collective training and development, thematic learning and development sessions for the whole Board have taken place.

Specific training has been organised for Board committees including the Remuneration and Appointments Committee, the Audit Committee, the Exposures Committee and the Risk Committee. In addition, one to one support has been provided to a number of directors.

In addition, directors receive information on the operation of the Board's committees, including the powers delegated to the committees, corporate governance practices and procedures and the powers reserved to the Executive together with the latest financial information. This is supplemented by meetings with key senior executives where appropriate, together with in depth training and round table sessions on specific areas.

The directors' website has been used as a resource bank to enable directors to access, revisit and review copies of presentations and materials from the more formal development sessions.

Individual learning and development records were issued to all non-executive directors summarising activity through the year and individual learning plans are in progress with a view to constructing the framework for individual and collective learning and development going forwards.

The Chair addresses the development needs of the Board as a whole, with a view to developing its effectiveness. He ensures that the directors' professional development needs are identified and that they are adequately informed about the Group and their responsibilities as directors.

Performance evaluation

The Code requires the Board to undertake a formal and rigorous annual evaluation of its own performance and that of its committees and individual directors.

Further to the external evaluation of the Board's effectiveness at the end of 2010, the only significant recommendation (in respect of the size and composition of the Board) was addressed during the year as described above.

A three year programme of assessment of Board and committee effectiveness exercises and peer evaluations was introduced during last year. In 2011, one third of the Board was the subject of a peer evaluation selected on length of service from first appointment to the Board, subject to having served at least one year on the Board as at 30 June.

An internal self assessment of Board effectiveness is also underway.

Each year, the Board committees undergo internal self assessment of their effectiveness. In this year both Audit and Exposures Committees carried out self assessment exercises. The other committees did not carry out assessments as they believed that given the high number of changes to the committees it was not appropriate until the new members had an opportunity to integrate into the committees.

Statutory disclosures information

Relations with members

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

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 AGM, but the shares only hold 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 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.

Principal activities

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

Results and dividends

Profit before taxation and significant items was £197.5m (2010: £108.7m). Profit attributable to the ordinary shareholders amounted to £48.0m (2010: £36.4m). No dividends were paid during 2011. The directors recommend that no final dividend is paid in respect of 2011.

Report of the Board of Directors continued

Risk management

The Board and executive management have the primary responsibility for identifying the key business risks facing the organisation. The risk management framework, which is approved and reviewed by the Bank 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 financial statements.

An independent review of the Bank risk management framework was completed in 2011. The objective of the review was to consider whether the current framework is capable of enabling good risk governance and to make recommendations for improvement. The review considered the current framework to be suitable for an organisation of Bank's size and complexity. Areas which could be improved are being acted upon by the Executive.

The Board accepts that there are risks which could impact on the achievement of 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 members' interests and reserves.

Further information on the Bank's approach to risk management is given on page 46 and details of KPIs are on page 2.

Internal control

Internal controls are the activities undertaken by management, the Board and other parties to enhance risk management and increase the probability that established objectives and goals will be achieved. 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 Bank'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 internal control framework 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, colleagues, suppliers, community and competitors;
- a whistleblowing policy and procedure which provides for any employee to report, in confidence, suspected serious malpractice;
- internal audit, risk and compliance functions that review the system of internal control; and
- a control self assessment process designed to fully support the annual review of the effectiveness of the system of internal control and enable continual monitoring and improvement of the internal control environment.

External audit

The current auditor is KPMG Audit Plc. In line with good corporate governance a tender process took place during 2011 to consider the appointment of the external auditors to The Co-operative Group. A resolution to appoint and authorise the directors to fix their remuneration was proposed and approved at the Annual General Meeting (AGM) on 12 May 2011 and was also approved by the AGM of The Co-operative Group on 21 May 2011.

The Audit 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 auditors. The external auditors are permitted to provide some non-audit services that are not, and are not perceived to be, in conflict with their independence. The Audit Committee receives at each meeting a report providing details of assignments (and related financial fees) carried out by the external auditors of the Bank in addition to their statutory audit work. The pre-approval of the committee is required for services above certain thresholds determined by the committee.

In addition, the following assignments are prohibited from being performed by the external auditors:

- 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 Committee may determine.

The performance of the external auditors 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 reports to the Audit 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 key business risks are effectively managed by key controls.

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 Audit Committee. Full details of the operation of this committee can be found on page 13.

Going concern

The financial statements are prepared on a going concern basis as the directors are satisfied that the Group and parent company have the resources to continue in business for the foreseeable future. In making this assessment, the directors have considered a wide range of information relating to present and future conditions including future projections of profitability, cash flows and capital resources. Further information relevant to the assessment is provided within the basis of preparation section of the financial statements (page 38).

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 are provided with information on strategy and objectives through their reporting lines and a formal performance measurement process. Newsletters, bulletins and electronic media communicate other information as well as the Company's intranet.

Employees
The Bank and its subsidiary undertakings employed 8,528 persons at 31 December 2011 (2010: 8,583). The weekly average number of people was 8,364 (2010: 8,746) and their aggregate remuneration, before significant items, for the year was £210.8m (2010: £221.0m). The Bank, as part of the Banking Group operates learning and development initiatives across the organisation as part of a continuous improvement programme, supporting its approach to performance management, personal development, talent and succession planning.

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

Employees with disabilities
The Bank, as part of the Banking Group, is a member of the following diversity advisory bodies:

- Employers Forum on Disability;
- Employers Forum on Age;
- Race for Opportunity;
- Opportunity Now; and
- Stonewall.

The Banking Group 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 Banking Group has policies and processes in place to support disabled colleagues in the workplace.

Further guidance and information for colleagues on disability issues is available through human resources and on the colleagues' intranet. The Banking Group recognises its responsibility for making reasonable adjustments for new colleagues with disabilities and for those individuals who develop disabilities whilst in employment.

Employees' wellbeing
The Bank, as part of the Banking Group, recognises that health and wellbeing at work play a vital part in delivering its core values. Wellbeing services include an occupational health scheme, physiotherapy services and seasonal wellbeing initiatives such as discounted allergy testing and flu jabs.

In addition to this, colleagues and their immediate families have access to an external employee assistance programme, providing free expert advice on a wide range of medical, legal and family issues.

Corporate responsibility
The Bank's corporate responsibility activities are outlined on pages 11 and 12. In addition, The Co-operative Group Sustainability Report, which will be published in the first half of 2012, describes how the Co-operative Group Limited, the Banking Group, the Bank, Co-operative Insurance Society Limited and CIS General Insurance Limited manage their social, ethical and environmental impacts.

Political and charitable donations
During the year, CFS Management Services Limited, a subsidiary of the Banking Group, made donations (which exclude affinity card payments) of £0.3m to charitable organisations on behalf of the Bank (2010: £0.4m). A further £0.5m of donations were made directly by the Bank with £0.4m allocated through the Britannia Foundation. 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.

Outlets
At 31 December 2011 the Bank had 342 branches (2010: 342 branches).

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. These have been internally assessed at a market value of £75.2m which is £14.5m higher than carrying value.

Supplier payment policy and practice
With the exception of the Britannia business area detailed below, the Bank does not pay suppliers directly as all supplies and services are sourced through CFS Management Services Limited, a fellow subsidiary of the Banking Group. A management charge is payable to cover the cost of these services.

Suppliers are paid directly by the former Britannia business where the policy is to agree the terms of payment at the start of trading with the supplier, ensure that suppliers are aware of the terms of payment and pay in accordance with its contractual and other obligations. Creditor days at 31 December 2011 were 27 (2010: 16 days).

Post balance sheet events
The directors consider that there has been no event since the year end that has had a significant effect on the Bank's position or that of any of its connected undertakings.

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

Report of the Board of Directors continued

Statement of directors' responsibilities in respect of the report of the Board of Directors and the Annual Report and Financial statements

The directors are responsible for preparing the annual report and financial statements and the Group and parent company financial statements in accordance with applicable law and regulations.

Company law requires the directors to prepare Group and parent company financial statements for each financial year. Under that law they are required to prepare the Group financial statements in accordance with International Financial Reporting Standards (IFRS) as adopted by the EU and applicable law and have elected to prepare the parent company financial statements on the same basis.

Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Group and parent company and of their profit or loss for that period. In preparing each of the Group and parent company financial statements, the directors are required to:

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

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

Under applicable law and regulations, the directors are also responsible for preparing a remuneration report, a directors' report and a corporate governance report that comply with that law and those regulations.

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.

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.

Auditors

In accordance with Section 489 of the Companies Act 2006, resolutions for the appointment and remuneration of the auditors are proposed at the next AGM and set out on page 124. Further detail in relation to the appointment of the auditors is set out on page 16.

By Order of the Board
Moira Lees, Group Secretary

28 March 2012

Remuneration report

The Co-operative Bank (the Bank), in the interests of good governance uses as a guideline for its remuneration disclosure the requirements applicable to listed companies, as set out in schedule 8 of the Large and Medium Sized Companies and Groups (Accounts and Reports) Regulations 2008 (incorporated into the Companies Act 2006). This remuneration report will be subject to an advisory vote by shareholders of the Company at its Annual General Meeting to be held on 12 May 2012.

This report provides details of the remuneration of both the senior executives (including executive directors and executive committee members) and the non-executive directors.

The key considerations this year are:

- continuation of extensive dialogue with the Financial Services Authority (FSA) in connection with our current and future remuneration practices. All remuneration arrangements and practices in place are compliant with the FSA Remuneration Code (the Code); and
- the introduction of a new long term incentive plan (LTIP) with effect from 1 January 2011, based on the wider performance of The Co-operative Group and which replaces the previous LTIP, which was based on performance of The Co-operative Banking Group only.

During 2011 there was a reorganisation of the Board to increase its levels of both independence and diversity. The number of directors on the Board was reduced from 20 to a total of 15. As part of the reorganisation Rod Bulmer, Tim Franklin and Phil Lee stood down as directors. These senior executives remained on the executive committee and attend Board meetings as required.

These considerations are covered in detail in the body of the report.

Introduction
The remuneration report is presented by the Board and contains the following information:

- a description of the role of The Co-operative Banking Group Remuneration and Appointments Committee (the committee), in governing senior executive remuneration in the Bank;
- a summary of the Bank's remuneration policy, including a statement of policy on senior executives and non-executive directors; and
- details of the terms of the service contracts and the remuneration of the senior executives and non-executive directors for the 2011 financial year.

The Remuneration and Appointments Committee meets as a combined committee for The Co-operative Banking Group and the Bank. Its role is described below.

Role of the committee
The committee's terms of reference were last revised and approved by the Bank's Board on 12 May 2010.

The committee's principal terms of reference, with regard to the Bank, are to:

- determine the policy on remuneration and other main terms and conditions of employment of senior executives;
- oversee contractual arrangements for the senior executives and approve the principal terms and conditions of employment of such senior executives;
- review remuneration using comparisons against the agreed market policy for the senior executives;
- make recommendations on senior executive appointments and the terms and conditions relating to these;
- review and agree the remuneration policy and outcomes in respect of all designated code staff under the FSA Remuneration Code;
- approve any relevant incentive schemes, ensure that they are in line with current market practice and the FSA Remuneration Code, and authorise payments under any incentive schemes in line with their rules; and
- receive, review and decide on issues raised in relation to retirement benefit schemes across the Bank and advise the Board on these issues as appropriate.

The Co-operative Group Remuneration and Appointments Committee governs remuneration in respect of the role of the Bank's Chief Executive.

The terms of reference for the committee are available on The Co-operative Banking Group website.

Members of the committee during 2011 were Rodney Baker-Bates (Deputy Chair Co-operative Banking Group) as Chair, together with Len Wardle (Co-operative Group Chair), Peter Marks (Co-operative Group Chief Executive), Paul Flowers (Co-operative Banking Group Chair) and David Davies (Deputy Chair, Co-operative Banking Group). The Board believes that all members of the committee are independent for the purpose of reviewing remuneration matters.

The Bank's Chief Executive and the HR Director are also invited to attend meetings of the committee except when their own remuneration is being discussed. The Chief Risk Officer provides an annual report to the committee and advice on any specific risk adjustments in relation to remuneration issues as required by the FSA. Other individuals were invited to attend for specific agenda items when necessary. The committee worked with The Co-operative Group Remuneration and Appointments Committee to ensure consistency, where appropriate, with arrangements across the wider Co-operative Group.

The committee members are all non-executive directors. They have no personal financial interests in the committee's decisions, and they have no involvement in the day to day management of the Bank.

The committee met five times in the year to 31 December 2011.

To ensure that it receives independent advice on remuneration matters, the committee retained New Bridge Street (an Aon Hewitt company) as its advisers during 2011. New Bridge Street has supplied survey data and advised on market trends and other general remuneration issues. Other than specialist advice in relation to remuneration matters, New Bridge Street does not provide other services to the Bank. Addleshaw Goddard was also retained to provide legal advice to the committee with respect to senior executives' service contracts.

Policy on directors' remuneration
In determining the remuneration policy for senior executives, the committee has considered a number of factors including:

- the importance of attracting, retaining and motivating senior executives of the appropriate calibre to further the success of the Bank;
- the linking of reward to business and individual performance and the application of co-operative values, which include a strong belief in responsible stewardship of all the Bank's resources and prudent management of risk;
- the alignment of the interests of senior executives with those of the wider Group and its members;
- pay practices and conditions of all employees throughout the Bank;
- the motivational impact of incentive arrangements to ensure that they are effective and do not adversely impact matters such as governance, environmental and social issues;
- in conjunction with the Group Remuneration and Appointments Committee ensuring that pay practices are coherent with those in The Co-operative Group as a whole; and
- ensuring appropriate compliance with the FSA Remuneration Code.

Remuneration report continued

The current policy is to pay senior executives base salaries around the market median, when compared with other organisations of comparable size and complexity in relevant business sectors. The committee supports the principle of performance related pay and operates an annual incentive plan (AIP) and a long term incentive plan (LTIP) which, together, mean that over 50% of the remuneration package is performance related. The committee does not consider it appropriate to adhere to the size of variable pay typically available in public limited companies (PLCs) and accordingly the amounts payable under these plans are lower than in comparable PLCs. Together, the AIP and LTIP represent total variable remuneration, with awards under the LTIP comprising the deferred element of variable remuneration as required by the FSA.

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 market remuneration practice. Accordingly, the committee keeps the Bank's remuneration policy under review.

Whilst the business climate in financial services remains challenging, the Bank has remained resilient through the period, having a robust model based on sound co-operative principles (which avoid undue risk taking or reliance on a single business stream). In particular, the absence of highly 'geared' incentive plans (when compared with some practices in the PLC sector) is consistent with prudent risk management.

The committee notes that the remuneration practices already adopted at the Bank, in addition to being good business practice, have been endorsed by the FSA through its Remuneration Code. However, the committee will continue to strive for further improvements in its executive remuneration arrangements as best practice evolves.

The main components of senior executive remuneration are summarised in the table below:

Element	Remuneration objective	Details
Base salary	To provide a competitive base salary to attract and retain talented leaders	Reviewed annually. Targeted around market median
Benefits	To provide executive benefits in line with normal market practice	Car or car allowance, fuel cards, phone and life assurance
Pension	To aid retention and reward long service, whilst controlling the Bank's liabilities	The Co-operative Group provides a Defined Benefit pension plan (on the same career average basis as other employees) or an equivalent cash pension allowance
Annual incentive plan	To ensure pay is linked to the Bank's financial and strategic business objectives and co-operative values	Up to 60% of salary based on annual Bank's financial and non-financial targets
Long term incentive plan	To reward senior executives for delivery of superior long term performance and to retain talent	Awards up to 100% of base salary for the CEO and 75% for other senior executives based on stretching three year Co-operative Group financial and non-financial targets

1. Base salary
It is the committee's policy to ensure that the base salary for each senior executive is appropriate and competitive, for the responsibilities involved and experience required. Base salaries for senior executives are reviewed by the committee, usually annually, having regard to competitive market practice, business and individual performance during the financial year and salary levels throughout the Company. Comparative pay data is used carefully, recognising the potential for an upward ratchet in remuneration caused by over reliance on such data. Any increases are normally effective from the start of the financial year. Base salary is the only element of remuneration that is pensionable. Salaries received by senior executives in respect of 2011 are set out in table 1 and 1a.

2. Annual incentive plan (AIP)
Each senior executive is eligible to participate in the AIP.

The committee reviews and sets incentive targets and levels of eligibility annually.

The design and terms of the 2011 plan are as follows:

- target payment levels for all of the executive team are 35% of base salary with a maximum opportunity of 60%; and
- based on a mixture of financial and non-financial measures derived from the corporate balanced scorecard.

The balanced scorecard approach represents best practice as set out in the FSA Remuneration Code and is aligned to the goals of the business.

The measures and weightings in the balanced scorecard are as set out below:

- financial (35%): operating profit;
- process (35%): cost v budget;
- customer (15%): customer advocacy; and
- people (15%): colleague engagement score.

All balanced scorecard performance measures and results are audited by externally appointed auditors.

The Chief Executive's AIP is based 2/3rds on the above Bank's targets; the balance is based on targets for the wider Co-operative Group: Group profit (70%), Group corporate responsibility (10%), Group colleague engagement (10%) and Group customer satisfaction (10%).

In addition to achieving performance against the balanced scorecard measures (including the Chief Executive's Group AIP element), four further underpins must be achieved before any payment is made. These are as follows:

1. A threshold profit level must be achieved before any element becomes payable.
2. The Bank must stay within its required liquidity range as agreed by The Co-operative Banking Group Board.
3. The Bank must stay above its required minimum capital level as agreed by The Co-operative Banking Group Board.
4. There should be no material breaches of risk in accordance with the risk appetite as agreed by The Co-operative Banking Group Board. The Chief Risk Officer is required to provide an annual report to the committee before bonus payments are signed off.

Additional deferral is also required by the FSA Code: 50% of any AIP earned is paid in March or April following the year end, while the remaining 50% is deferred for an additional six months subject to specified conditions and clawback.

Similar performance conditions will apply for the 2012 AIP.

For the 2011 AIP, bonus on average resulted in payments of 38.1% of base salary, representing slightly above target balanced scorecard performance. For those senior executives new in role, payments are lower to represent previous roles held. In accordance with the FSA Remuneration Code for those senior executives that are not awarded 2012–14 LTIP, deferral of 60% of the AIP bonus is required, fully subject to performance conditions and clawback. Payment, if any, will be 50% in years 3 and 3.5. Of the AIP bonus payments due in April, 50% will be deferred for six months subject to specified conditions and clawback. Details of awards to senior executives are set out in table 1 and 1a.

3. Long term incentive plan (LTIP)

A new LTIP representing deferred remuneration under the FSA Remuneration Code was introduced with effect from 1 January 2011. The plan is designed to focus and align the leadership team with the long term strategy of The Co-operative Group, and aid the retention of talent. The plan measures cumulative performance over a three year period. The 2011 award will be measured over the three year period 2011 to 2013 with potential payment in 2014. It is intended that awards will be made annually thereafter.

The maximum award opportunity under the LTIP is 75% of base salary for senior executives and 100% of base salary for the Chief Executive. These awards represent the maximum amount payable in respect of each three year performance period. The actual amount of award vesting is subject to the achievement of the long term performance measures.

The performance measures are based on the performance of The Co-operative Group (inclusive of the Bank's performance) over a three year period as set out in the balanced scorecard, the measures being designed to ensure delivery of strategic targets. The specific measures for 2011 to 2013 are:

- Cumulative Co-operative Group profit, subject to also achieving a minimum level of average Return on Net Operating Assets (RONOA) (70%);
- Group corporate responsibility (10%);
- Group colleague engagement (10%); and
- Group customer satisfaction (10%).

All balanced scorecard performance measures and results are audited by externally appointed auditors.

Additionally, the financial and risk underpins applicable to the AIP also apply to the LTIP ie the four underpins must be met for any LTIP to become payable. These underpins are to provide appropriate risk adjustment and to be compliant with the FSA Remuneration Code.

Additional deferral is required by the FSA Code: at the point of vesting, 50% of any payment will be deferred for an additional six months subject to specified conditions and clawback (ie for 50% of the LTIP award the total deferral period from grant is 3.5 years).

The 2009–11 LTIP cycle was completed in January 2012. Performance was based on the Bank's shareholder profit, cost management, customer satisfaction and colleague engagement. Details of payment due under the 2009–11 plan cycles are set out in tables 1 and 1a (column performance related pay medium/long term). These equate to 79% of the original grant reflecting maximum awards of 39% to 47%.

To summarise, senior executives' LTIP grants for 2010–12 and 2011–13 remain outstanding. Payments, if any, would be made in 2013 and 2014 respectively, with 50% of due awards retained for an additional six months subject to additional performance conditions. 2011 LTIP terms are still in the process of being agreed by the FSA, once terms of the plan are agreed, grants will be made.

4. Clawback and malus

With effect from the 2010 LTIP grant, and for AIP payments in respect of 2011 performance onwards, including any deferred element, a clawback provision will apply. This enables the committee to seek to recoup part or all of an annual incentive or LTIP payment in the exceptional events that it was based on misstated performance results or if a senior executive is dismissed for gross misconduct.

The Bank also operates malus, ie a provision where the value of deferred remuneration (ie the element deferred for six months under the AIP and LTIP) can be adjusted downwards to take account of specified conditions.

5. Service agreements

It is the Bank's policy that the notice period in senior executives' service contracts should not exceed one year. Senior executives have consistent contracts that are terminable by up to one year's notice by the organisation and six month's notice by the individual. In the event of termination, the standard payment due to a senior executive is based on the value of one year's base salary and contractual benefits. (In (exceptional) circumstances such as a major re-organisation or merger, termination payments to executives leaving the Bank have been enhanced, but applying a formula that is no more generous than that applying to other Bank colleagues leaving the Group in the same circumstances.) The details of the termination payments made to senior executives leaving the Bank during 2011 are disclosed in tables 1 and 1a. The committee may make a discretionary award of bonus earned up to the date of termination of employment. Any such award would be subject to deferral in accordance with the FSA Remuneration Code.

All the Bank senior executives had similar contracts during 2011. The dates of existing contracts or dates of appointment are shown in table 1 and 1a.

Remuneration report continued

Senior executives' joining and leaving arrangements in 2011

- Neville Richardson resigned from the Board on 22 July 2011 and was paid his contractual remuneration until 31 December 2011
- Tim Franklin resigned from the Executive Committee on 30 November 2011 and was paid his contractual remuneration until 31 December 2011
- Karen Moir resigned from the Executive Committee on 30 September 2011
- James Mack was appointed to the Executive Committee as acting CFO on 1 August 2011
- Helen Taylor was appointed to the Executive Committee on 1 October 2011

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

Non-executive directorships

The committee has determined that, subject to the committee's approval, senior executives 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, The Co-operative Banking Group or The Co-operative Group.

Phil Lee holds such a position; non-executive director within EG Solutions PLC.

6. Share option plans

As a co-operative, the Bank does not operate a share or share option plan.

7. Pensions

The financial services businesses participate in The Co-operative Group Pension (Average Career Earnings) Scheme (the PACE Scheme). However, following the merger with Britannia Building Society on 1 August 2009, colleagues who at that date were members of the Britannia Pension Scheme (the Britannia Scheme) continue in membership of the Britannia Scheme. From 1 August 2009, for the interim, only the defined contribution section of the Britannia Scheme is available to new colleagues of the financial services businesses.

The PACE Scheme, which is a registered occupational pension scheme, provides defined benefit (DB) pensions based on 1/60th of average pensionable earnings, re-valued for inflation for each year of pensionable service from 6 April 2006 (the date the PACE Scheme was implemented). Benefits accrued as at 5 April 2006, in respect of membership of the scheme preceding the PACE Scheme, 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 dependants on death and a lump sum is payable if death occurs in service.

The Britannia Scheme, which is also a registered occupational pension scheme, provides benefits under two sections:

- A defined benefit (DB) section (closed to new colleagues), which provides pensions based on an accrual of 1/80th, 1/60th or up to 1/30th for executives, of final pensionable salary for each year of pensionable service.
- A defined contribution (DC) section (open to new colleagues) with an employer contribution rate of 4%, 6% or 8% depending on the level of member contribution.

Under both sections, pensions are also payable to dependants 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 whilst members of the Britannia Scheme contribute either 6% or 8% of their pensionable salary if they are in the DB section. The employer pays the balance of cost of providing DB benefits. Members of the Britannia Scheme DC section pay 2%, 3% or 4% of their pensionable salary. All members have the choice of making pension contributions by salary sacrifice.

Prior to the merger on 1 August 2009, Neville Richardson, Tim Franklin and Phil Lee had contractual arrangements under which they accrued pension benefits in an unfunded employer financed retirement scheme (EFRBS). The EFRBS is in place to provide pension benefits that exceed the lifetime allowance. Benefits up to the lifetime allowance will be provided from the Britannia Scheme. These contractual arrangements and those for Karen Moir were revised from 1 August 2009 and the rate of benefit aligned more closely to Group executive pension policy. These arrangements were further adjusted from 1 August 2011 so that the rate of future pension accrual made available under the Britannia Scheme was aligned to that provided by the PACE Scheme, with no further accrual in the EFRBS.

In light of the pension tax changes applying to registered schemes from 6 April 2011, Group executive pension policy was revised. Where an executive may be impacted by the annual allowance or the lifetime allowance they have the facility of opting out of future pension accrual in favour of a pension allowance or opting for restricted pension accrual based on a capped salary of £187,500 and receiving a restricted pension allowance in lieu of pension provision based on salary above £187,500.

Where paid, the rate of pension allowance is based on the employer contribution rate to the PACE Scheme of currently 16.7% of pensionable salary (16% prior to July 2011).

On this basis, Barry Tootell opted for restricted pension accrual with effect from 6 April 2011 and was paid a restricted pension allowance.

James Mack is a member of the Britannia Scheme DC section and has a contractual arrangement under which the employer contribution rate is 12%.

All other executives accrued full pension benefits as members of either the PACE Scheme or the Britannia Scheme during the year.

Supplementary life cover is provided to executives in order to provide total life cover of four times salary when aggregated with benefits from the relevant pension scheme, as appropriate.

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.

The basic fee for a non-executive director elected to sit on The Co-operative Group Board who is also appointed to serve on the Banking Group Board and its principal subsidiaries (including the Bank) is £16,302 per annum, and these same non-executive directors receive additional fees for serving on the various Banking Group Board committees (which also have responsibility for Bank business). The Chair's fee is £113,025 per annum.

Following a benchmarking exercise by New Bridge Street in 2010 which was approved by The Co-operative Group Board the six independent professional non-executive directors and the professional external non-executive director received a fee of £57,002 per annum. Co-operative Group Board Directors serving on the various committees, as well as Chairs of the various committees also receive additional fees, as do the Deputy Chairs for the Board, to reflect their additional responsibilities. Fees were increased in line with RPI in 2011. The increase in fees in 2011 was 3.7%, effective from 1 June 2011. The independent professional non-executive directors and professional external non-executive director now receive £59,966.

The independent professional non-executive directors and the professional external 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. These service agreements expire on 31 July 2014, with the exception of David Davies whose service agreements expire on 31 July 2013.

The Co-operative Group Board may resolve to reappoint any of the independent professional non-executive directors at or before the date their service agreements expire for a further three year term. It is the normal policy of the Board not to allow an independent professional non-executive director to serve for more than nine years in aggregate.

The non-executive directors' service agreements contain no specific provision for liquidated damages on early termination of an agreement.

None of the independent professional non-executive directors are directors of The Co-operative Group or members of any Co-operative Group pension scheme or incentive plan.

Details of the directors' year of appointment and fees are shown in table 3.

Code staff remuneration
Code staff are defined by the FSA as those having a material impact on a firm's risk profile, including a person who performs a significant influence function for a firm, a senior manager and risk takers.

Remuneration policy and outcomes for code staff are determined by the committee. The design of the component parts of remuneration is as set out for the senior executives. For all code staff, performance related pay is risk adjusted through the use of the underpins to the incentive plans, together with the application of deferrals, clawback and malus adjustments in accordance with the FSA Remuneration Code.

Details of the aggregate remuneration information required by the FSA is shown in table 4 and are in respect of all the Bank's Group code staff. The amounts shown in respect of senior executives and non-executive directors do not represent additional remuneration.

By Order of the Board

Rodney Baker-Bates,
Chair, Co-operative Banking Group Remuneration and Appointments Committee

28 March 2012

Remuneration report continued

Table 1 – Emoluments of senior executives (executive directors) for the year ending 31 December 2011

	Date of service contract or appointment	Basic salary £000	Other supplements(1) £000	Performance related pay annual(2) £000	Benefits in kind(3) £000	Total related to 2011 £000	Performance related pay medium/long term(4) £000	2011 Total emoluments £000	2010 Total emoluments(5) £000
Neville Richardson(6) (11)	1 August 2009	398	8	109	3	518	220	738	1,196
Barry Tootell(7) (11)	4 April 2008	448	50	153	5	656	110	766	691
Rod Bulmer(8) (11)	1 June 2008	183	7	63	1	254	45	299	754
Tim Franklin(8) (11)	1 August 2009	186	8	26	1	221	58	279	701
Phil Lee(8) (11)	1 August 2009	186	3	26	4	219	58	277	700
Total		1,401	76	377	14	1,868	491	2,359	4,042
Former directors who served the Bank in 2010(9)								–	425
Compensation for loss of office(10)								1,390	–
								3,749	4,467

The table above represents total emoluments for executive directors in relation to their services for The Co-operative Banking Group.

(1) Other supplements include full or partial pension allowances in lieu of a pension provision, car allowance, phone and healthcare supplements (ie non P11D items).

(2) Performance related pay (annual) refers to bonus amounts earned in respect of 2011. To comply with the FSA Remuneration Code, 50% of the 2011 annual bonus quoted is deferred for six months subject to further performance conditions and clawback. In addition as Neville Richardson is not eligible for 2012–14 LTIP, 60% of the 2011 annual bonus has been deferred (50% for 3 years and 50% for 3.5 years) to comply with FSA deferral rules. The deferred amount is subject to performance conditions and is not quoted in the emoluments table. This amount equates to £163k.

(3) Benefits in kind for Neville Richardson and Phil Lee are in respect of company cars and healthcare cover, Tim Franklin and Barry Tootell are both in respect of healthcare cover (ie P11D items).

(4) Performance related pay (medium/long term) refers to compensatory amounts paid in respect of the lost opportunity as a result of the early vesting of the 2009–11 LTIP plan.

(5) 2010 Total emoluments were in respect of a full year for all executive directors.

(6) Neville Richardson resigned as Chief Executive Officer on 22 July 2011.

(7) Barry Tootell was appointed Acting Chief Executive Officer on 22 July 2011.

(8) Rod Bulmer, Tim Franklin and Phil Lee were executive directors until 16 June 2011. The 2011 emoluments therefore were in respect of a part year only.

(9) John Reizenstein served as executive director until 7 December 2010, emoluments were in respect of a part year.

(10) Compensation for loss of office was in respect of Neville Richardson. Following his resignation on 22 July, Neville received a further payment of £380k for continued employment to 31 December 2011.

(11) In accordance with the FSA Remuneration Code, payment of 60% of 2011 variable pay is deferred over a three year period. Variable pay comprises annual bonus in respect of 2011 plus long term incentive awarded in 2012 in respect of the 2011 year.

Table 1a – Emoluments of senior executives (members of the executive committee) for the year ending 31 December 2011

	Date of service contract or appointment	Basic salary £000	Other supplements[1] £000	Performance related pay annual[2] £000	Benefits in kind[3] £000	Total related to 2011 £000	Performance related pay medium/long term[4] £000	2011 Total emoluments £000	2010 Total emoluments[5] £000
Rod Bulmer[6] [12]	1 June 2008	217	9	74	–	300	53	353	–
Tim Franklin[6] [7] [12]	1 August 2009	186	8	30	–	224	69	293	–
Phil Lee[6] [12]	1 August 2009	221	5	30	5	261	69	330	–
Mike Fairbairn[12]	16 January 2006	237	17	33	3	290	62	352	420
Keith Alderson[12]	1 October 2010	256	17	88	1	362	30	392	94
Karen Moir[8] [12]	1 August 2009	203	12	28	1	244	76	320	483
James Mack[9] [12]	1 August 2011	93	4	25	–	122	–	122	–
Helen Taylor[10] [12]	1 October 2011	50	3	17	–	70	11	81	–
Total		1,463	75	325	10	1,873	370	2,243	997
Compensation for loss of office[11]								1,159	–
								3,402	997

The table above represents total emoluments for executive directors in relation to their services for The Co-operative Banking Group.

(1) Other supplements include full or partial pension allowances in lieu of a pension provision, car allowance, phone and healthcare supplements (ie non P11D items).

(2) Performance related pay (annual) refers to bonus amounts earned in respect of 2011. To comply with the FSA Remuneration Code, 50% of the 2011 annual bonus quoted is deferred for six months subject to further performance conditions and clawback. In addition for executives not eligible for 2012–14 LTIP, 60% of the 2011 annual bonus has been deferred (50% for 3 years and 50% for 3.5 years) to comply with FSA deferral rules. The deferred amount is subject to performance conditions and is not quoted in the emoluments table. These amounts equate to £84k for Phil Lee, £42k for Karen Moir, £84k for Tim Franklin and £49k for Mike Fairbairn respectively.

(3) Benefits in kind are in respect of company car for Phil Lee and medical insurance for Rod Bulmer, Mike Fairbairn, Keith Alderson, Karen Moir and Phil Lee (ie P11D items).

(4) Performance related pay (medium/long term) refers to compensatory amounts paid in respect of the lost opportunity as a result of the early vesting of the 2009–11 LTIP plan.

(5) 2010 Total emoluments were in respect of a full year for all executive committee members.

(6) Rod Bulmer, Tim Franklin and Phil Lee were appointed to the Executive Committee on 17 June 2011. The 2011 emoluments represent earnings from that date.

(7) Tim Franklin resigned as Executive Officer on 30 November 2011.

(8) Karen Moir resigned on 30 September 2011.

(9) James Mack was appointed to the Executive Committee on 1 August 2011. The emoluments shown represent his earnings from that date.

(10) Helen Taylor was appointed to the Executive Committee on 1 October 2011. The emoluments shown represent her earnings from that date.

(11) Compensation for loss of office in 2011 was in respect of Karen Moir £466,000 and Tim Franklin £692.500. In addition, Tim Franklin received payment of £41,000 for continued employment up to 31 December 2011. Karen Moir also received £3,000 in lieu of holiday pay.

(12) In accordance with the FSA Code of Practice, payment of 60% of 2011 variable pay is deferred over a three year period. Variable pay comprises annual bonus in respect of 2011 plan plus long term incentive awarded in 2012 in respect of the 2011 year.

Remuneration report continued

Table 2 – Pension details of senior executives (executive directors or members of the Executive Committee)

	Years of service	Total accrued pension at 31 December 2011 £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 31 December 2011 net of members' contributions £000	Transfer value of total accrued pension at 31 December 2010 £000	Transfer value of total accrued pension at 31 December 2011 £000	Increase in transfer value net of members' contributions £000
Neville Richardson(5)	13	43	(98)	(105)	(2,830)	2,903	1,161	(1,788)
Barry Tootell(6)	3	21	5	4	33	166	274	94
Keith Alderson(7)	8	29	7	6	71	282	451	153
Rod Bulmer(8)	4	20	7	6	42	99	210	87
Mike Fairbairn(9)	36	69	4	1	(15)	1,415	1,664	235
Tim Franklin(10)	11	59	(28)	(33)	(785)	1,536	1,382	(180)
Phil Lee(11)	9	88	9	5	87	1,717	2,326	582
James Mack(12)	1	–	–	–	–	–	–	–
Karen Moir(13)	10	64	5	2	32	1,164	1,406	229
Helen Taylor(14)	4	15	4	3	25	96	172	64

General notes

(1) The table above includes all senior executives who were either executive directors or members of the Executive Committee (or who switched status during the year) for the year ending 31 December 2011 and shows their pension details for the period during the year they were in the employment of the Banking Group.

(2) Pension scheme members have the option of paying additional voluntary contributions to their respective pension scheme. Neither these contributions nor the benefits arising from them are shown in the above table.

(3) Years of service include, where appropriate, pre-merger service with Britannia. The total accrued pension is that which would be paid annually on retirement at normal retirement age, based on service to 31 December 2011, and includes any transferred in benefits as appropriate. Under the terms of their contracts, existing senior executives at 17 January 2007 (only Mike Fairbairn now falls into this category) may take these benefits from age 60 and new executives after 17 January 2007 may take these benefits from age 65. The transfer values in the table above have been calculated on this basis.

(4) All transfer values have been calculated in accordance with the current transfer value method and basis in force for the scheme applicable to the senior executive. This is set by the Trustee(s), after taking actuarial advice, to be consistent with the requirements of legislation and the rules of the scheme.

Individual notes

(5) Neville Richardson resigned as Chief Executive Officer on 22 July 2011 and left the Banking Group on 31 December 2011. He became entitled to a deferred pension from the Britannia Scheme DB section when he left the scheme at the same date. The details shown in the table are calculated at that date. During the year Neville chose to take the value of his EFRBS as a taxable lump sum of £2,120,000 rather than as pension. The negative numbers shown on the table reflect the effect of this.

(6) Barry Tootell (previously an executive director) was appointed Acting Chief Executive Officer on 22 July 2011. He opted for restricted pension accrual from 6 April 2011 and was paid a restricted pension allowance.

(7) Keith Alderson was a member of the Executive Committee during the year.

(8) Rod Bulmer was an executive director until 16 June 2011. He was appointed to the Executive Committee on 17 June 2011.

(9) Mike Fairbairn was a member of the Executive Committee during the year. The figures shown on the table at the start of the year and at the year end are after application of a pension sharing order.

(10) Tim Franklin was an executive director until 16 June 2011. He was appointed to the Executive Committee on 17 June 2011 and resigned on 30 November 2011. He became entitled to a deferred pension from the Britannia Scheme DB section when he left the scheme on 31 December 2011. The details shown in the table are calculated at that date. During the year Tim chose to take the value of his EFRBS as a taxable lump sum of £575,000 rather than as pension. The negative numbers shown on the table reflect the effect of this.

(11) Phil Lee was an executive director until 16 June 2011. He was appointed to the Executive Committee on 17 June 2011.

(12) James Mack was appointed to the Executive Committee on 1 August 2011. He is a member of the Britannia Scheme DC section and his pension details are shown on table 2a.

(13) Karen Moir resigned from the Executive Committee on 30 September 2011. She became entitled to a deferred pension under the Britannia Scheme DB section when she left the scheme at the same date. The details shown in the table are calculated at that date.

(14) Helen Taylor was appointed to the Executive Committee on 1 October 2011.

Table 2a – Defined contributions paid for senior executives

Name	Amount £
James Mack	21,530

Table 3 – Non-executive directors' remuneration

Non-executive directors	Date appointed	2011 fees £000	2010 fees £000
Paul Flowers[(1) (20)]	2009	**120**	83
Duncan Bowdler[(3) (18)]	2009	**17**	16
Peter Marks[(2)]	2009	**–**	–
Ben Reid[(3) (4)]	2009	**20**	19
Len Wardle[(3) (18) (20)]	2006	**23**	16
Martyn Wates[(2)]	2007	**–**	–
Steve Watts[(3) (13)]	2006	**10**	18
Independent professional non-executive directors (IPNEDS)			
Rodney Baker-Bates[(5) (6)]	2009	**75**	66
David Davies[(5) (6) (17)]	2003	**85**	68
Peter Harvey[(5) (7) (9)]	2009	**68**	57
Chris Jones[(5) (11) (19)]	2009	**102**	72
Stephen Kingsley[(5) (8) (12)]	2009	**93**	58
Bob Newton[(5) (8) (21)]	2007	**88**	56
Piers Williamson[(5) (9) (14)]	2005	**46**	58
Anne Gunther[(5) (15)]	2011	**19**	–
Merlyn Lowther[(5) (16)]	2011	**16**	–
Professional non-executive director (PNED)			
Paul Hewitt[(5) (10)]	2003	**68**	66

Notes

(1) The Chair of the Board receives £113,025.
(2) Peter Marks and Martyn Wates are employees of The Co-operative Group. Although they are entitled to fees of £16,302 they have both agreed to waive them.
(3) The non-executive directors that also serve on the Group Board receive a fee of £16,302 per annum for serving on the Banking Group Board.
(4) Ben Reid, as a non-executive director who is a member of the Banking Group Audit Committee and who is not an IPNED, receives an additional £3,111 per annum.
(5) Under their service contracts, the IPNEDs and PNED receive a fee from June 2011 of £59,996 per annum.
(6) The Deputy Chairs receive an additional fee of £15,720 per annum.
(7) The Chair of the Banking Group Exposures Committee receives an additional £5,240 per annum. This amount is pro rata if the position is held for part of the year.
(8) The Chair of the Banking Group Transformation Committee receives an additional £7,336 per annum. This amount is pro rata if the position is held for part of the year.
(9) The Chair of the Banking Group Risk Management Committee receives an additional £11,004 per annum. This amount is pro rata if the position is held for part of the year.
(10) The Chair of the Banking Group Audit Committee receives an additional £11,004 per annum. This amount is pro rata if the position is held for part of the year.
(11) The Chair of Illius Properties Limited receives a fee of £15,000 per annum.
(12) Stephen Kingsley stepped down from the Board with effect from 16 June 2011. His remuneration also incorporates his compensation for loss of office of £57,002.
(13) Steve Watts stepped down from the Board with effect from 8 July 2011.
(14) Piers Williamson stepped down from the Board with effect from 8 September 2011.
(15) Anne Gunther was appointed as an IPNED from 8 September 2011.
(16) Merlyn Lowther was appointed as an IPNED from 7 September 2011.
(17) David Davies receives £11,004 as the Chair of PACE.
(18) The non-executive directors that also serve on the Group Board receive a fee of £3,260 per annum for serving on the Banking Group Exposures Committee.
(19) Chris Jones stepped down from the Board with effect from 31 August 2011. His remuneration also incorporates his compensation for loss of office of £57,002.
(20) The non-executive directors that also serve on the Group Board receive a fee of £2,174 per annum for serving on the Banking Group Remuneration and Appointments Committee.
(21) Bob Newton receives a fee of £25,000 per annum for being on the Board of the Reclaim Fund Limited.

Remuneration report continued

Table 4 – Aggregate information in respect of code staff

Number of code staff	Total remuneration(1) £000	Total fixed remuneration(2) £000	Total variable remuneration(3) £000	Annual incentive plan(4) £000	Long term incentive plan(5) £000	Outstanding deferred remuneration(6) £000	Deferred reduced and paid £000	Sign on and severance payments £000	Severance payments made in year(8) £000
Senior management 27(7)	7,398	5,025	2,373	1,205	1,168	421	–	–	2,549
Other code staff 40	9,472	6,870	2,602	1,495	1,107	46	–	–	2,962

The table above represents the emoluments of code staff in relation to their services for The Co-operative Bank.

(1) Total remuneration consists of base salary, allowances, employer pension contributions and incentive payments relating to the 2011 financial year, together with future earnings opportunity comprised in the 2012–14 long term incentive awards.

(2) Total fixed remuneration is base salary plus allowances and employer pension contributions.

(3) Total variable remuneration is the sum of the annual incentive plan payments in respect of the 2011 financial year and the awards made under the 2012–14 long term incentive plan. The awards under the 2012–14 long term plan are performance related and, to the extent achieved will be payable 50% in 2015 and 50% in 2016. All payments as and when due are made in cash.

(4) Payments made under the annual incentive plan are in respect of the 2011 financial year.

(5) Awards made under the 2012–14 long term incentive plan are all unvested and represent deferred remuneration in respect of the 2011 financial year, in accordance with the FSA Remuneration Code.

(6) The outstanding deferred remuneration is deferred cash where no long term incentive award is made or the award is insufficient to satisfy the deferral percentage required by the FSA. These amounts are quoted in annual incentive plan totals and do not represent additional payments.

(7) Senior management consists of executive directors, members of the executive committee and non-executive directors.

(8) Severance payments are in respect of redundancy for both senior managers and other code staff. Fourteen code staff were made redundant in 2011. Severance terms include both redundancy payments and the buyout of notice.

Independent auditor's report to the members of The Co-operative Bank plc

We have audited the financial statements of The Co-operative Bank plc for the year ended 31 December 2011 set out on pages 30 to 68 and pages 71 to 122. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the EU and, as regards the parent company financial statements, as applied in accordance with the provisions of the Companies Act 2006.

This report is made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and reporting on corporate governance, on terms that have been agreed. 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 reporting on corporate governance, those matters that we have agreed to state to them in our 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

As explained more fully in the directors' responsibilities statement set out on page 18, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit, and express an opinion on, the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's (APB's) Ethical Standards for Auditors.

Scope of the audit of the financial statements

A description of the scope of an audit of financial statements is provided on the APB's website at www.frc.org.uk/apb/scope/private.cfm.

Opinion on financial statements

In our opinion:

- the financial statements give a true and fair view of the state of the Group's and of the parent company's affairs as at 31 December 2011 and of the Group's profit for the year then ended;
- the Group financial statements have been properly prepared in accordance with IFRSs as adopted by the EU;
- the parent company financial statements have been properly prepared in accordance with IFRSs as adopted by the EU and as applied in accordance with the provisions of the Companies Act 2006; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006 and, as regards the Group financial statements, Article 4 of the IAS Regulation.

Opinion on other matters prescribed by the Companies Act 2006

In our opinion:

- the information given in the directors' report for the financial year for which the financial statements are prepared is consistent with the financial statements; and
- the information given in the corporate governance statement set out on pages 11 to 18 with respect to internal control and risk management systems in relation to financial reporting processes and about share capital structures is consistent with the financial statements.

Matters on which we are required to report by exception

We have nothing to report in respect of the following:

Under the Companies Act 2006 we are required to report to you if, in our opinion:

- adequate accounting records have not been kept by the parent company, or returns adequate for our audit have not been received from branches not visited by us; or
- the parent company financial statements are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

Under the Listing Rules we are required to review the directors' statement, set out on page 16, in relation to going concern.

In addition to our audit of the financial statements, the directors have engaged us to review their corporate governance statement as if the Company were required to comply with the Listing Rules and the Disclosure Rules and Transparency Rules of the Financial Services Authority in relation to those matters. Under the terms of our engagement, we are required to review the part of the corporate governance statement on pages 11 to 18 relating to the Company's compliance with the nine provisions of the UK Corporate Governance Code specified for our review.

Andrew Walker, Senior Statutory Auditor
for and on behalf of KPMG Audit Plc, Statutory Auditor
Chartered Accountants
St James Square
Manchester
M2 6DS

28 March 2012

Consolidated income statement

For the year ended 31 December 2011

All amounts are stated in £m unless otherwise indicated

	Notes	**Before significant items 2011**	**Significant items 2011**	**After significant items 2011**	Before significant items 2010	Significant items 2010	After significant items 2010
Interest receivable and similar income	4	**1,583.7**	**–**	**1,583.7**	1,713.3	–	1,713.3
Interest expense and similar charges	4	**(948.7)**	**–**	**(948.7)**	(1,104.9)	–	(1,104.9)
Net interest income		**635.0**	**–**	**635.0**	608.4	–	608.4
Fee and commission income	5	**239.6**	**(90.0)**	**149.6**	237.2	(13.1)	224.1
Fee and commission expense	5	**(54.4)**	**–**	**(54.4)**	(60.3)	–	(60.3)
Net fee and commission income		**185.2**	**(90.0)**	**95.2**	176.9	(13.1)	163.8
Net trading income	6	**4.5**	**–**	**4.5**	4.6	–	4.6
Other operating income	7	**46.3**	**–**	**46.3**	8.1	–	8.1
Operating income		**871.0**	**(90.0)**	**781.0**	798.0	(13.1)	784.9
Operating expenses	8	**(528.7)**	**(53.3)**	**(582.0)**	(571.9)	(46.7)	(618.6)
Financial Services Compensation Scheme levies	32	**(14.5)**	**–**	**(14.5)**	(11.5)	–	(11.5)
Operating profit before impairment losses		**327.8**	**(143.3)**	**184.5**	214.6	(59.8)	154.8
Impairment losses on loans and advances	15	**(120.5)**	**–**	**(120.5)**	(97.3)	–	(97.3)
Impairment gains on investments	16	**5.6**	**–**	**5.6**	1.5	–	1.5
Operating profit		**212.9**	**(143.3)**	**69.6**	118.8	(59.8)	59.0
Share of post tax profits from joint ventures	36	**0.2**	**–**	**0.2**	0.7	–	0.7
Profit before taxation and profit based payments		**213.1**	**(143.3)**	**69.8**	119.5	(59.8)	59.7
Profit based payments to members of The Co-operative Group		**(15.6)**	**–**	**(15.6)**	(10.8)	–	(10.8)
Profit before taxation	2	**197.5**	**(143.3)**	**54.2**	108.7	(59.8)	48.9
Income tax	10	**(42.4)**	**38.0**	**(4.4)**	(29.8)	16.7	(13.1)
Profit for the financial year		**155.1**	**(105.3)**	**49.8**	78.9	(43.1)	35.8
Attributable to:							
Equity shareholders	12	**153.3**	**(105.3)**	**48.0**	79.5	(43.1)	36.4
Minority interests		**1.8**	**–**	**1.8**	(0.6)	–	(0.6)
		155.1	**(105.3)**	**49.8**	78.9	(43.1)	35.8
Earnings per share (basic and diluted)	12	**1.87p**	**(1.28)p**	**0.59p**	1.67p	(0.90)p	0.77p

The significant items in 2011 and 2010 relate to a programme of investment and integration and to provisions made for customer compensation relating to past sales of payment protection insurance (PPI) and customer redress (notes 5, 8 and 32).

Consolidated statement of comprehensive income

For the year ended 31 December 2011

All amounts are stated in £m unless otherwise indicated

	Group					
	Equity shareholders 2011	**Minority interests 2011**	**Total 2011**	Equity shareholders 2010	Minority interests 2010	Total 2010
Profit for the financial year	**48.0**	**1.8**	**49.8**	36.4	(0.6)	35.8
Other comprehensive income/(expense):						
Changes in cashflow hedges						
Net changes in fair value recognised directly in equity	**88.9**	**0.3**	**89.2**	(2.8)	(0.7)	(3.5)
Income tax	**(19.8)**	**(0.1)**	**(19.9)**	1.3	0.2	1.5
Net gains transferred from equity to income or expense	**(49.3)**	**(0.3)**	**(49.6)**	–	(0.1)	(0.1)
Income tax	**10.9**	**0.1**	**11.0**	–	–	–
Changes in available for sale assets						
Net changes in fair value recognised directly in equity	**101.6**	**–**	**101.6**	(25.3)	–	(25.3)
Income tax	**(26.9)**	**–**	**(26.9)**	6.2	–	6.2
Transfers from equity to income or expense	**(55.8)**	**–**	**(55.8)**	4.8	–	4.8
Income tax	**14.8**	**–**	**14.8**	(1.3)	–	(1.3)
Revaluation of equity shares	**(1.5)**	**–**	**(1.5)**	–	–	–
Income tax	**0.4**	**–**	**0.4**	–	–	–
Defined benefit plan actuarial losses	**–**	**–**	**–**	(0.4)	–	(0.4)
Income tax	**(0.1)**	**–**	**(0.1)**	0.1	–	0.1
Other comprehensive income/(expense) for the financial year, net of income tax	**63.2**	**–**	**63.2**	(17.4)	(0.6)	(18.0)
Total comprehensive income for the financial year	**111.2**	**1.8**	**113.0**	19.0	(1.2)	17.8

The accounting policies and notes on pages 37 to 122 form part of these financial statements.

Consolidated balance sheet

At 31 December 2011

All amounts are stated in £m unless otherwise indicated

	Notes	2011	2010
Assets			
Cash and balances at central banks	13	**6,696.6**	1,735.6
Loans and advances to banks	14	**2,006.5**	2,394.1
Loans and advances to customers	15	**33,766.0**	34,977.3
Fair value adjustments for hedged risk	15	**366.3**	166.8
Investment securities – loans and receivables	16	**804.9**	1,917.3
Investment securities – available for sale	16	**3,423.0**	2,957.1
Investment securities – fair value through income or expense	16	**343.1**	28.7
Derivative financial instruments	17	**975.8**	975.6
Equity shares	18	**5.7**	7.2
Investments in joint ventures	36	**2.7**	2.5
Goodwill	19	**0.6**	0.6
Intangible fixed assets	20	**40.7**	45.1
Investment properties	21	**172.7**	162.3
Property, plant and equipment	22	**80.1**	98.5
Amounts owed by other Co-operative Group undertakings	37	**179.2**	0.6
Other assets	23	**46.6**	8.8
Prepayments and accrued income	24	**18.7**	16.2
Deferred tax assets	33	**26.4**	87.0
Total assets		**48,955.6**	45,581.3
Liabilities			
Deposits by banks	25	**3,302.7**	2,938.6
Customer accounts	26	**34,990.6**	32,320.0
Customer accounts – capital bonds	27	**1,429.8**	1,794.7
Debt securities in issue	28	**4,164.8**	4,212.2
Derivative financial instruments	17	**1,087.9**	702.4
Other borrowed funds	29	**1,258.8**	975.4
Amounts owed to other Co-operative Group undertakings	37	**132.3**	188.5
Other liabilities	30	**173.7**	146.8
Accruals and deferred income	31	**39.9**	131.3
Provisions for liabilities and charges	32	**102.0**	55.8
Current tax liabilities		**–**	42.5
Total liabilities		**46,682.5**	43,508.2
Capital and reserves attributable to the Bank's equity holders			
Ordinary share capital	38	**410.0**	410.0
Share premium account	38	**8.8**	8.8
Retained earnings		**1,733.8**	1,598.9
Available for sale reserve		**19.5**	(13.1)
Cashflow hedging reserve		**67.6**	36.9
		2,239.7	2,041.5
Minority interests		**33.4**	31.6
Total equity		**2,273.1**	2,073.1
Total liabilities and equity		**48,955.6**	45,581.3

Approved by the Board on 28 March 2012 and signed on its behalf by:

Paul Flowers, Chair
Barry Tootell, Acting Chief Executive
Moira Lees, Secretary

The accounting policies and notes on pages 37 to 122 form part of these financial statements.

Bank balance sheet

At 31 December 2011

All amounts are stated in £m unless otherwise indicated

	Notes	2011	2010
Assets			
Cash and balances at central banks	13	**6,696.6**	1,735.6
Loans and advances to banks	14	**1,300.1**	1,728.6
Loans and advances to customers	15	**22,735.0**	23,844.9
Fair value adjustments for hedged risk	15	**365.8**	164.6
Investment securities – loans and receivables	16	**866.1**	1,986.8
Investment securities – available for sale	16	**3,107.4**	2,621.4
Investment securities – fair value through income or expense	16	**343.1**	28.7
Derivative financial instruments	17	**704.4**	704.7
Equity shares	18	**5.7**	7.2
Investments in Group undertakings	36	**1,573.4**	1,458.9
Goodwill	19	**0.6**	0.6
Intangible fixed assets	20	**39.3**	43.8
Property, plant and equipment	22	**61.5**	79.1
Amounts owed by other Co-operative Group undertakings		**12,961.2**	14,233.7
Other assets	23	**77.5**	7.8
Prepayments and accrued income	24	**17.7**	14.5
Deferred tax assets	33	**110.3**	154.0
Total assets		**50,965.7**	48,814.9
Liabilities			
Deposits by banks	25	**3,239.8**	2,870.8
Customer accounts	26	**32,670.1**	29,912.0
Customer accounts – capital bonds	27	**1,397.3**	1,744.0
Debt securities in issue	28	**1,431.0**	1,856.8
Derivative financial instruments	17	**1,051.5**	697.4
Other borrowed funds	29	**1,258.8**	975.4
Amounts owed to other Co-operative Group undertakings		**7,461.2**	8,340.9
Other liabilities	30	**169.1**	140.5
Accruals and deferred income	31	**33.1**	117.0
Provisions for liabilities and charges	32	**93.4**	39.3
Current tax liabilities		**–**	17.3
Total liabilities		**48,805.3**	46,711.4
Capital and reserves attributable to the Bank's equity holders			
Ordinary share capital	38	**410.0**	410.0
Share premium account	38	**8.8**	8.8
Retained earnings		**1,655.0**	1,661.4
Available for sale reserve		**19.5**	(13.1)
Cashflow hedging reserve		**67.1**	36.4
Total equity		**2,160.4**	2,103.5
Total liabilities and equity		**50,965.7**	48,814.9

Approved by the Board on 28 March 2012 and signed on its behalf by:

Paul Flowers, Chair
Barry Tootell, Acting Chief Executive
Moira Lees, Secretary

The accounting policies and notes on pages 37 to 122 form part of these financial statements.

Consolidated statement of cash flows

For the year ended 31 December 2011

All amounts are stated in £m unless otherwise indicated

	2011	2010
Cash flows from operating activities		
Profit before taxation	**54.2**	48.9
Adjustments for:		
(Increase)/decrease in prepayments and accrued income	**(38.3)**	16.0
Decrease in accruals and deferred income	**(90.6)**	(81.9)
Interest payable in respect of other borrowed funds	**86.7**	45.5
Effect of exchange rate movements	**16.0**	(2.8)
Impairment losses on loans and advances	**130.5**	97.3
Movements on investment impairments	**(39.9)**	(1.5)
Depreciation and amortisation	**21.4**	26.3
Interest amortisation	**(15.7)**	(6.3)
Amortisation of investments	**(340.8)**	(40.6)
Loss on disposal of fixed assets	**0.3**	0.8
Unwind of fair value adjustments arising on transfer of engagements	**(86.3)**	14.2
Preference dividend	**5.6**	5.6
	(296.9)	121.5
Increase/(decrease) in deposits by banks	**364.1**	(3,143.8)
Increase in customer accounts and capital bonds	**2,306.7**	1,639.1
(Decrease)/increase in debt securities in issue	**(141.0)**	471.6
(Increase)/decrease in loans and advances to banks	**(73.2)**	401.5
Decrease/(increase) in loans and advances to customers	**1,034.2**	(850.6)
(Increase)/decrease in amounts owed by other Co-operative Group undertakings	**(178.6)**	90.4
Decrease in amounts owed to other Co-operative Group undertakings	**(56.2)**	(140.7)
Net movement of other assets and other liabilities	**532.3**	112.4
Income tax paid	**(21.2)**	(34.9)
Net cash flows from operating activities	**3,470.2**	(1,333.5)
Cash flows from investing activities		
Purchase of tangible and intangible fixed assets	**(14.8)**	(30.9)
Proceeds from sale of investment properties	**0.8**	0.5
Purchase of investment securities	**(3,667.6)**	(1,506.2)
Proceeds from sale and maturity of investment securities	**4,513.5**	3,757.2
Net cash flows from investing activities	**831.9**	2,220.6
Cash flows from financing activities		
Interest paid on other borrowed funds	**(69.6)**	(44.8)
Proceeds of issued shares	**–**	180.0
Repayment of other borrowed funds	**(102.3)**	–
Issuance of other borrowed funds	**273.6**	–
Preference share dividends paid	**(5.6)**	(5.6)
Capital contribution from parent	**87.0**	–
Dividends paid to minority shareholders in subsidiary undertaking	**–**	(0.8)
Net cash flows from financing activities	**183.1**	128.8
Increase in cash and cash equivalents	**4,485.2**	1,015.9
Cash and cash equivalents at the beginning of the financial year	**3,403.2**	2,387.3
Cash and cash equivalents at the end of the financial year	**7,888.4**	3,403.2
Cash and balances with central banks (note 13)	**6,658.6**	1,699.5
Loans and advances to banks (note 14)	**1,019.8**	1,478.7
Short term investments (note 16)	**210.0**	225.0
	7,888.4	3,403.2

The cash flows cannot be directly reconciled to the Group balance sheet movements as these movements include the non-cash unwinds of the fair value adjustments arising on the transfer of engagements of Britannia Building Society.

The accounting policies and notes on pages 37 to 122 form part of these financial statements.

Bank statement of cash flows

For the year ended 31 December 2011

All amounts are stated in £m unless otherwise indicated

	2011	2010
Cash flows from operating activities		
Profit before taxation	**(128.4)**	101.9
Adjustments for:		
(Increase)/decrease in prepayments and accrued income	**(39.0)**	14.1
Decrease in accruals and deferred income	**(82.9)**	(67.2)
Interest payable in respect of other borrowed funds	**86.7**	45.5
Effect of exchange rate movements	**16.0**	(2.8)
Impairment losses on loans and advances	**103.4**	94.5
Movements on investment impairments	**(39.9)**	(1.5)
Depreciation and amortisation	**23.9**	26.5
Interest amortisation	**(15.7)**	(6.3)
Amortisation of investments	**(296.7)**	(82.6)
Loss on disposal of fixed assets	**0.2**	0.8
Unwind of fair value adjustments arising on transfer of engagements	**(154.0)**	(234.3)
Preference dividends	**5.6**	5.6
	(520.8)	(105.8)
Increase/(decrease) in deposits by banks	**369.0**	(2,742.2)
Increase in customer accounts and capital bonds	**2,412.4**	1,398.6
(Decrease)/increase in debt securities in issue	**(433.3)**	98.4
(Increase)/decrease in loans and advances to banks	**(31.6)**	517.1
Decrease/(increase) in loans and advances to customers	**935.9**	(812.3)
Decrease/(increase) in amounts owed by other Co-operative Group undertakings	**1,272.5**	(2,372.1)
(Decrease)/increase in amounts owed to other Co-operative Group undertakings	**(879.7)**	2,575.9
Net movement of other assets and other liabilities	**359.6**	151.0
Income tax paid	**(8.2)**	(10.6)
Net cash flows from operating activities	**3,475.8**	(1,302.0)
Cash flows from investing activities		
Purchase of tangible and intangible fixed assets	**(2.4)**	(4.3)
Purchase of investment securities	**(3,237.6)**	(126.2)
Proceeds from sale and maturity of investment securities	**3,857.0**	2,330.3
Net cash flows from investing activities	**617.0**	2,199.8
Cash flows from financing activities		
Interest paid on other borrowed funds	**(69.6)**	(44.8)
Repayment of other borrowed funds	**(102.3)**	–
Issuance of other borrowed funds	**273.6**	–
Proceeds of issued shares	**–**	180.0
Preference share dividends paid	**(5.6)**	(5.6)
Capital contribution from parent	**87.0**	–
Net cash flows from financing activities	**183.1**	129.6
Increase in cash and cash equivalents	**4,275.9**	1,027.4
Cash and cash equivalents at the beginning of the financial year	**3,391.0**	2,363.6
Cash and cash equivalents at the end of the financial year	**7,666.9**	3,391.0
Cash and balances with central banks (note 13)	**6,658.6**	1,699.5
Loans and advances to banks (note 14)	**1,008.3**	1,466.5
Short term investments (note 16)	**–**	225.0
	7,666.9	3,391.0

The cash flows cannot be directly reconciled to the Bank balance sheet movements as these movements include the non-cash unwinds of the fair value adjustments arising on the transfer of engagements of Britannia Building Society.

The accounting policies and notes on pages 37 to 122 form part of these financial statements.

Consolidated and Bank statements of changes in equity

For the year ended 31 December 2011

All amounts are stated in £m unless otherwise indicated

	Attributable to equity holders of the Company							
	Share capital	Share premium	Available for sale reserve	Cashflow hedging reserve	Retained earnings	Total	Minority interest	Total equity
Group								
2011								
Balance at the beginning of the year	**410.0**	**8.8**	**(13.1)**	**36.9**	**1,598.9**	**2,041.5**	**31.6**	**2,073.1**
Total comprehensive income for the financial year	**–**	**–**	**32.6**	**30.7**	**47.9**	**111.2**	**1.8**	**113.0**
Transactions with owners recorded directly in equity:								
Capital contribution	**–**	**–**	**–**	**–**	**87.0**	**87.0**	**–**	**87.0**
Balance at the end of the year	**410.0**	**8.8**	**19.5**	**67.6**	**1,733.8**	**2,239.7**	**33.4**	**2,273.1**
Group								
2010								
Balance at the beginning of the year	230.0	8.8	2.5	38.4	1,562.8	1,842.5	33.6	1,876.1
Total comprehensive income for the financial year	–	–	(15.6)	(1.5)	36.1	19.0	(1.2)	17.8
Transactions with owners recorded directly in equity:								
Increase in share capital	180.0	–	–	–	–	180.0	–	180.0
Dividend	–	–	–	–	–	–	(0.8)	(0.8)
Balance at the end of the year	410.0	8.8	(13.1)	36.9	1,598.9	2,041.5	31.6	2,073.1

	Attributable to equity holders of the Company					
	Share capital	Share premium	Available for sale reserve	Cashflow hedging reserve	Retained earnings	Total equity
Bank						
2011						
Balance at the beginning of the year	**410.0**	**8.8**	**(13.1)**	**36.4**	**1,661.4**	**2,103.5**
Total comprehensive income for the financial year	**–**	**–**	**32.6**	**30.7**	**(93.4)**	**(30.1)**
Transactions with owners recorded directly in equity:						
Capital contribution	**–**	**–**	**–**	**–**	**87.0**	**87.0**
Balance at the end of the year	**410.0**	**8.8**	**19.5**	**67.1**	**1,655.0**	**2,160.4**
Bank						
2010						
Balance at the beginning of the year	230.0	8.8	2.5	37.7	1,588.5	1,867.5
Total comprehensive income for the financial year	–	–	(15.6)	(1.3)	72.9	56.0
Transactions with owners recorded directly in equity:						
Increase in share capital	180.0	–	–	–	–	180.0
Balance at the end of the year	410.0	8.8	(13.1)	36.4	1,661.4	2,103.5

The accounting policies and notes on pages 37 to 122 form part of these financial statements.

Basis of preparation and significant accounting policies

For the year ended 31 December 2011

The Co-operative Bank plc is registered in England and Wales under the Companies Act 2006.

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 (IFRS) as issued by the International Accounting Standards Board (IASB), and IFRS Interpretations Committee (IFRIC) guidance as adopted by the European Union (EU). On including the parent company financial statements here together with the Group financial statements, the Company is taking advantage of the exemption in Section 408 of the Companies Act 2006 not to present its individual income statement and related notes that form a part of these approved financial statements. Information in respect of the Company alone is labelled throughout as 'Bank'.

The financial information has been prepared under the historic cost convention as modified by the revaluation of available for sale financial assets, derivative contracts, investment properties and certain other financial assets and financial liabilities held at fair value. The Group applies the recognition, measurement and disclosure requirements of IFRS in issue that are endorsed by the EU and are effective for accounting periods beginning on or after 1 January 2011.

Standards and interpretations issued and effective

In preparing these consolidated financial statements, the Group has adopted the following pronouncements during the year that are new or revised but have no material impact on the financial statements:

- Revised IAS 24 (Related Party Disclosures (2009))
  IAS 24 requires entities to disclose in their financial statements information about transactions with related parties. In broad terms, two parties are related to each other if one party controls, or significantly influences, the other party.

  The standard simplifies the disclosure requirements for government related entities and clarifies the definition of a related party.

- IFRIC 19 (Extinguishing Financial Liabilities with Equity Instruments (2009))
  This interpretation addresses the accounting by an entity when the terms of a financial liability are renegotiated and result in the entity issuing equity instruments to a creditor of the entity to extinguish all or part of the financial liability. It does not address the accounting by the creditor.

Standards and interpretations issued but not yet effective

- Amended IFRS 7 (Disclosures: Transfers of Financial Assets (2010))
  This amendment's objective is to promote the transparency of off balance sheet activities, particularly in relation to the securitisation of financial assets. Specifically, the transference of these assets and their associated risks shall be reported in a way that ensures that the user of the accounts is able to understand the financial position of such risks being transferred.

  It becomes effective for the year beginning 1 January 2012 which is the first annual accounting period beginning on or after 1 July 2011. The impact of the amendment to IFRS 7 is unlikely to be material to the Group because all of the Group's existing securitisations are on balance sheet.

- IFRS 9 (Financial Instruments: Classification and Measurement (2010))
  This new standard's objective is to gradually phase out IAS 39 (Financial Instruments: Recognition and Measurement (2009)). Phase one of this process specifically requires financial assets to be classified as at amortised cost or at fair value. Consequently, the available for sale category currently used by the Group will become void. IFRS 9 incorporates IAS 39's authority on financial liabilities, recognising them at either amortised cost or fair value, but refines treatment of own credit risk fair value from being taken in the income statement to being taken through other comprehensive income. Further development phases for IFRS 9 are scheduled to cover key areas such as impairment, hedge accounting and the offsetting of assets and liabilities.

  It becomes effective as of 1 January 2015. Early adoption is permitted, once endorsed by the EU. The impact of IFRS 9 is likely to be material to the Group, due to the magnitude of financial instruments held on the Group's balance sheet. Given the standard's changing scope, a detailed materiality assessment of its impact is not currently possible.

- IFRS 10 (Consolidated Financial Statements (2011))
  This new standard establishes principles for the presentation and preparation of consolidated financial statements when an entity controls one or more other entities. It supersedes both IAS 27 (Consolidated and Separate Financial Statements (2008)) except where IAS 27 still applies as noted below and Amended SIC 12 (Consolidation: Special Purpose Entities (2004)). It aims to provide transparency in identifying off balance sheet, parent subsidiary relationships, using a consistent basis for determining the existence and thus consolidation of those underlying entities being controlled by the reporting entity.

  It becomes effective as of 1 January 2013. Early adoption is permitted, once endorsed by the EU. The impact to the Group of IFRS 10 is currently being considered in accordance with its effective date.

- IFRS 11 (Joint Arrangements (2011))
  This new standard establishes principles for financial reporting by parties to a joint arrangement. It supersedes both IAS 31 (Interests in Joint Ventures (2010)) and Amended SIC 13 (Jointly Controlled Entities: Non-Monetary Contributions by Venturers (2007)). Recognition criteria now distinguish between joint operations and joint ventures on their relative 'rights and obligations' scope. A joint operation interest is accounted for between assets, liabilities, revenue and expense, whilst a joint venture is restricted to equity accounting.

  It becomes effective as of 1 January 2013. Early adoption is permitted, once endorsed by the EU. The impact to the Group of IFRS 11 is currently being considered in accordance with its effective date.

- IFRS 12 (Disclosure of Interests in Other Entities (2011))
  This new standard applies to entities that have an interest in a subsidiary, a joint arrangement, an associate or an unconsolidated structured entity. It aims to provide disclosure transparency on the reporting entity's risks associated with its interests in other entities, in conjunction with IFRS 10's application which determines the existence of such entities.

  It becomes effective as of 1 January 2013. Early adoption is permitted, once endorsed by the EU. The impact to the Group of IFRS 12 is currently being considered in accordance with its effective date.

Basis of preparation and significant accounting policies continued
For the year ended 31 December 2011

Basis of preparation continued

- IFRS 13 (Fair Value Measurement (2011))
  This new standard defines fair value and also acts as its single authority, dealing primarily with both its measurement and disclosure. It does not require fair value measurements in addition to those already required, or permitted by other IFRSs, and is not intended to establish valuation standards or affect valuation practices outside of financial reporting.

  It becomes effective as of 1 January 2013. Early adoption is permitted, once endorsed by the EU. The impact to the Group of IFRS 13 is currently being considered in accordance with its effective date.

- Amended IAS 1 (Presentation of Financial Statements on the Statement of Comprehensive Income (2010))
  This amendment proposes to split the presentation of other comprehensive income into two sections. The different sections will distinguish between items which may or may not be recycled into any future income or expense.

  It becomes effective as of 1 July 2012. Early adoption is permitted, once endorsed by the EU. The impact of the amendment to IAS 1 is likely to be immaterial to the Group.

- Amended IAS 12 (Income Taxes: Deferred Tax – Recovery of Underlying Assets (2010))
  This amendment's objective is to refine IAS 12's measurement of deferred tax which relates to the recovery of an entity's assets. Previously, the standard stated that an asset's recovery would occur only when it was either used or sold. However, and as a consequence of this amendment, investment properties measured at fair value are excluded from the standard's scope on recovery.

  It becomes effective as of 1 January 2012. Early adoption is permitted, once endorsed by the EU. The impact of the amendment to IAS 12 is likely to be immaterial to the Group.

- Revised IAS 19 (Employee Benefits (2011))
  This revision covers the standard's recognition, measurement and presentation criteria with regard to a pension scheme's expense contained within IAS 19's 'defined benefit' scope. Actuarial gains or losses will now be fully recognised within income or expense, thus removing the previous partial recognition of 'corridor and spreading'.

  Furthermore, the revision eliminates the 'expected return on assets' from the measurement of a pension's expense and directs entities to instead charge a cost of finance against its net unfunded liability position.

  When determining a discount rate, that calculates a pension obligation's present value, reference should be made to market yields. These yields should be matched to high quality corporate bonds, in terms of both the obligation's currency and maturity, ahead of any previously assumed government bond yield reference point.

  It becomes effective as of 1 January 2013. Early adoption is permitted, once endorsed by the EU. The impact of the revision to IAS 19 is likely to be material to the Group, due to the likely impact on the pension costs recharged to the Group.

- Amended IAS 27 (Consolidated and Separate Financial Statements (2011))
  This amendment occurs as a direct consequence of IFRS 10's issuance, which now acts as the new single authority on consolidation requirements. IAS 27's scope has therefore reduced and focuses more specifically on separate financial statements' accounting bases. An entity shall therefore prepare its separate financial statements using one of two bases; either at cost or in accordance with IFRS 9.

  It becomes effective as of 1 January 2013. Early adoption is permitted, once endorsed by the EU. The impact of the amendment to IAS 27 is likely to be immaterial to the Group.

- Amended IAS 28 (Investments in Associates and Joint Ventures (2011))
  This amendment occurs as a direct consequence of IFRS 11's issuance, which now acts as the new single authority on joint arrangements. IAS 28 changes in order to consistently apply equity accounting methods for both joint ventures and associates. An entity shall therefore use IAS 28's equity accounting method, when accounting for any of IFRS 11's joint arrangements.

  It becomes effective as of 1 January 2013. Early adoption is permitted, once endorsed by the EU. The impact of the amendment to IAS 28 is likely to be immaterial to the Group.

  Other standards and interpretations have been issued but these are not considered to be relevant to the Group's operations.

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 and financial review on pages 5 to 7. In addition, the risk management section on pages 46 to 70 includes the Group's objectives, policies and processes for managing its risk and details of its exposure to risk. The capital management section on page 71 provides information on the Group'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 and these provide assurance that the Group is sufficiently capitalised and adequately positioned in excess of liquidity stress tests.

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. When making this assessment, the directors act within the principles of the Financial Reporting Council's 'Going Concern and Liquidity Risk: Guidance for Directors of UK Companies 2009' report.

Basis of preparation continued

Use of estimates and judgments

The preparation of financial statements requires management to make judgments, 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 judgments 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 46 to 70 and the critical judgments section on pages 73 to 74.

Significant accounting policies

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

(1) Business combinations

On 1 August 2009 The Co-operative Bank plc merged with Britannia Building Society, with Britannia transferring their engagements to the Group.

This business combination has been accounted for applying the requirements of IFRS 3 (Business Combinations (2004)).

The consideration transferred was valued by reference to the members' interests acquired. Financial assets and liabilities which, following the Group's accounting policies, would be carried at amortised cost, were brought onto the balance sheet at their fair value at acquisition and were subsequently carried at amortised cost using the effective interest rate method. The income statement includes the results of the engagements transferred from Britannia since the date of acquisition.

(2) Basis of consolidation

(a) Subsidiaries

Subsidiaries are entities controlled by the Group. Control exists whenever the Group 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 Group.

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

(b) Special purpose entities

Special purpose entities (SPEs) are entities that are created to accomplish a narrow and well defined objective; for the Group this includes:

- various securitisation transactions in which mortgages were sold to SPEs. The equity of these SPEs is not owned by the Group; and
- Covered Bond Limited Liability Partnerships created in order to act as a guarantor for the issue of covered bonds (refer to note 36 for further information).

An SPE is consolidated if, based on an evaluation of the substance of its relationship with the Group and the SPE's risks and rewards, the Group concludes that it controls the SPE.

The following circumstances may indicate a relationship in which, in substance, the Group controls and consequently consolidates an SPE:

- the activities of the SPE are being conducted on behalf of the Group according to its specific business needs so that the Group obtains benefits from the SPE's operation;
- the Group has the decision making powers to obtain the majority of the benefits of the activities of the SPE;
- the Group has the rights to obtain the majority of the benefits of the SPE and therefore may be exposed to the risks incidental to the activities of the SPE; or
- the Group 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 Group has control over an SPE is carried out at inception. No further assessment of control is carried out unless changes in the structure or terms of the SPE or additional transactions between the Group and the SPE occur.

(c) Interests in joint ventures

The Group's interests in joint ventures are accounted for using the equity method. The consolidated financial statements include the Group's share of the income and expenses and equity movements of equity accounted investees, after adjustments to align the accounting policies with those of the Group.

(3) Revenue recognition

(a) Interest income and expense

Interest income and expense is recognised on an effective interest rate (EIR) basis, inclusive of directly attributable incremental transaction costs and fees including arrangement and broker fees, valuation and solicitor costs, discounts and premiums where appropriate and early redemption fees.

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

For assets acquired at a value significantly below the carrying value in the acquiree's financial statements because they have incurred loss, expectations of future loss are higher than at origination, and interest spreads have widened because of deteriorating market conditions, the calculation of EIR is the same as shown above with the exception that the estimates of future cash flows include credit losses.

Basis of preparation and significant accounting policies continued
For the year ended 31 December 2011

Significant accounting policies continued

(b) Fees and commissions

Fee and commission income is predominantly made up of arrangement and other fees relating to loans and advances to customers that are included in the effective interest calculation. Commitment fees received are deferred and included in the EIR calculation upon completion or taken in full at the date the commitment period expires and completion does not occur.

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.

All other fee and commission income, such as loan closure fees or arrears fees, not included in the effective interest calculation, is recognised on an accruals basis as the service is provided.

(4) Significant items

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

The separate reporting of significant items helps to provide an indication of the Group's underlying business performance. Events which may give rise to the classification of items as significant include individually significant programmes of restructuring, investment, integration and provisions for material non-recurring items.

(5) Financial instruments (excluding derivatives)

(a) 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.

(b) Derecognition

Financial assets are derecognised when they are qualifying transfers and:

- the rights to receive cash flows from the assets have ceased; or
- the Group has transferred substantially all the risks and rewards of ownership of the assets.

When available for sale financial assets are derecognised the cumulative gain or loss, including that previously recognised in reserves, is recognised in the income statement.

A financial liability is derecognised when the obligation is discharged, cancelled or expires. Any difference between the carrying amount of a financial liability derecognised and the consideration paid is recognised through the income statement.

(c) Financial assets

i) Overview

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

- loans and receivables;
- available for sale; or
- financial assets at fair value through income statement.

ii) Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market and the 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 EIR method of any difference between the amount advanced and the maturity amount less impairment provisions for incurred losses.

Loans and receivables mainly comprise loans and advances to banks and customers (except where the Group has elected to carry the loans and advances to customers at fair value through income or expense as described in accounting policy (5c. iv. below)) and assets reclassified from available for sale (see below).

iii) Available for sale

Available for sale financial assets are debt securities that are not held for trading and are intended to be held for an indefinite period of time. These are measured at fair value based on current bid prices where quoted in an active market. Where the securities are unlisted the fair values are based on valuation techniques including discounted cashflow analysis, with reference to relevant market rates, and other commonly used valuation techniques. Movements in fair value are recorded in equity as they occur. On disposal, gains and losses recognised previously in equity are transferred to the income statement. In exceptional circumstances, for instance where the market in the securities has become inactive, the Group has reclassified such assets as loans and receivables.

Any transfer back from loans and receivables, upon reclassification, would be measured at fair value based on current bid prices where quoted in an active market. Where there is no active market or the securities are unlisted the fair values are based on valuation techniques including discounted cashflow analysis, with reference to relevant market rates, and other commonly used valuation techniques.

Significant accounting policies continued

iv) Financial assets at fair value through income or expense

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 income or expense to eliminate or significantly reduce a measurement and recognition inconsistency or where management specifically manages an asset or liability on that basis ie capital bonds.

These are measured at fair value based on current bid prices where quoted in an active market. Where there is no active market or the securities are unlisted the fair values are based on valuation techniques including discounted cashflow analysis, with reference to relevant market rates, and other commonly used valuation techniques. Gains and losses arising from changes in the fair value are brought into the income statement within trading income as they arise.

(d) Financial liabilities

i) Overview

Financial liabilities are contractual obligations to deliver cash or another financial asset. Financial liabilities are recognised initially at fair value, net of directly attributable transaction costs.

Financial liabilities, other than derivatives and capital bonds, are subsequently measured at amortised cost.

Certain non-derivative financial liabilities included within customer accounts (capital bonds) have been designated at fair value upon initial recognition in the balance sheet. Changes in fair value are recognised through the income statement. The capital bonds are economically matched using equity linked derivatives, which do not meet the requirements for hedge accounting. Recording changes in fair value of both the derivatives and the related liabilities through the income statement most closely reflects the economic reality of the transactions. In doing so this accounting treatment eliminates a measurement inconsistency that would otherwise arise from valuing the capital bonds at amortised cost and the derivatives at fair value.

ii) Borrowed funds

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

The Group classifies capital instruments as financial liabilities or equity instruments in accordance with the substance of the contractual terms of the instruments. The Group'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 29) 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 EIR method.

iii) Perpetual subordinated bonds

Perpetual subordinated bonds are carried at their nominal value plus any premium and a fair value adjustment for hedged risk where items are designated as part of a fair value hedge relationship.

Interest payable on perpetual subordinated bonds is recognised in the income statement using the EIR method.

(6) Impairment provisions

(a) Assessment

i) Objective evidence

At the balance sheet date, the Group assesses its financial assets not at fair value through income or expense for objective evidence that an impairment loss has been 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, or 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.

ii) Forbearance

The Group operates a policy of forbearance which mitigates against borrower default. All such cases are included within its provisioning methodology. For further information on the Group's approach to forbearance, its management and execution, see the risk management section on pages 46 to 70.

(b) Scope

i) Individual accounts

All individually significant loans and advances are assessed specifically for impairment using a range of watchlists progressively graded for higher levels of risk. Accounts at risk of impairment are monitored and impaired from the point at which they display clear indication of underperformance. Loans and advances not individually significant are collectively assessed for impairment by grouping together loans and advances of similar risk characteristics.

ii) Collective accounts

a) Retail

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. The model's results are adjusted for management's judgment as to whether current economic and credit conditions are such that actual losses are likely to differ from those suggested by historical modelling. Once impaired, accounts are subjected to higher levels of impairment according to both their relevant stage of delinquency, ie the number of days in arrears, and their consequent likelihood of ultimately being charged off. Default rates, loss rates and future recoveries are regularly benchmarked against actual outcomes to ensure that they remain appropriate.

Basis of preparation and significant accounting policies continued
For the year ended 31 December 2011

Significant accounting policies continued

(6) Impairment provisions continued

b) Corporate

Collective risk cover provides further balance sheet protection for total impairment losses. The amount of collective risk cover is adjusted monthly by the Group. The Group reviews all higher risk loans and considers the potential loss which might arise were the borrowers to fail (notwithstanding that continued trading remains the expectation). Events which may trigger higher risk status include a deteriorating balance sheet, material losses, trading difficulties (eg loss of material contracts or suppliers), breach of financial covenants, poor account conduct, arrears and material reduction in value of security. A collective impairment provision is raised against these loans based on the total estimated loss that may arise and the propensity for the borrower to fail.

(c) Measurement

The amount of the loss is the difference between:

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

Where the debt is secured, the assessment reflects the expected cash flows from the realisation of the security, net of cost to realise, whether or not foreclosure or realisation of the collateral is probable.

(d) Impairment of financial assets carried at amortised cost

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

A write off is made when all or part of a claim is deemed uncollectable or forgiven after all the possible collection procedures have been completed and the amount of loss has been determined. Write offs are charged against previously established provisions for impairment or directly to the income statement. Any additional recoveries from borrowers, counterparties or other third parties made in future periods are offset against the write off charge in the income statement once they are received.

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

(e) Impairment of financial assets classified as available for sale

Available for sale assets are assessed at each balance sheet date to see whether there is objective evidence of impairment. In such cases, any impairment losses are recognised by transferring the cumulative loss that has been recognised directly in equity to income or expense.

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

(7) Offsetting

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

(8) Sale and repurchase agreements

Securities sold subject to repurchase agreements (repos) are reclassified on the balance sheet as pledged assets when the transferee has the right by contract or custom to sell or repledge the assets. The liability to the transferee is also included on the balance sheet, in deposits by banks. The difference between sale and repurchase price is accrued over the life of the agreements using the EIR method.

Securities purchased under agreements to re-sell (reverse repos) are classified as loans and advances to banks on the balance sheet, as appropriate.

Securities lent to counterparties are retained on the balance sheet.

Securities borrowed are not recognised on the balance sheet, unless they are sold to third parties, in which case the purchase and sale are recorded. The obligation to return them is recorded at fair value as a trading liability.

(9) Derivative financial instruments and hedge accounting

(a) Derivatives used for asset and liability management purposes

Derivatives are used to hedge interest and exchange rate exposures related to non-trading positions. Instruments used for hedging purposes include swaps, forward rate agreements, futures, options and combinations of these instruments. The Group also uses equity derivatives to hedge the equity risks within its capital bonds.

Derivative financial instruments are stated at fair value based on quoted market prices in active markets, and where these are not available, using valuation techniques such as discounted cashflow models. Further information is provided on page 116. All derivatives are carried as assets when the fair value is positive and liabilities when the fair value is negative. The gain or loss on re-measurement to fair value is recognised immediately in the income statement except where derivatives qualify for cashflow hedge accounting.

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

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

Significant accounting policies continued

i) Cashflow hedges

Where derivatives are designated as hedges of the exposure to variability in cash flows of a recognised asset or liability, or a highly probable forecast transaction, the portion of the fair value gain or loss on the derivative that is determined to be an effective hedge is recognised directly in equity. The ineffective part of any gain or loss is recognised in the income statement immediately.

The accumulated gains and losses recognised in equity are reclassified to the income statement in the periods in which the hedged item will affect income or expense. When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss recognised at that time remains in equity until the forecast transaction is eventually recognised in the income statement.

When a forecast transaction is no longer expected to occur, the cumulative gain or loss that was recognised in equity is immediately reclassified to the income statement.

ii) Fair value hedges

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

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

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

iii) Fair value hedge accounting for a portfolio hedge of interest rate risk

As part of its risk management process the Group identifies portfolios whose interest rate risk it wishes to hedge. The portfolios may comprise only assets, only liabilities or both assets and liabilities. The Group analyses each portfolio into repricing time periods based on expected repricing dates, by scheduling cash flows into the periods in which they are expected to occur. Using this analysis, the Group decides the amount it wishes to hedge and designates as the hedged item an amount of assets or liabilities from each portfolio equal to this.

The Group measures monthly the change in fair value of the portfolio relating to the risk that is being hedged. Provided that the hedge has been highly effective the Group recognises the change in fair value of each hedged item in the income statement with the cumulative movement in its value being shown on the balance sheet as a separate item, fair value adjustment for hedged risk, either within assets or liabilities as appropriate. If the hedge no longer meets the criteria for hedge accounting, this amount is amortised to the income statement over the remaining average useful life of the hedge relationship.

The Group measures the fair value of each hedging instrument monthly. The value is included in derivative financial instruments in either assets or liabilities as appropriate, with the change in value recorded in the income statement.

Any hedge ineffectiveness is recognised in the income statement as the difference between the change in fair value of the hedged item and the change in fair value of the hedging instrument.

(b) Embedded derivatives

A derivative may be embedded in another instrument, known as the host contract. Where the economic characteristics and risks of an embedded derivative are not closely related to those of the host contract (and the host contract is not carried at fair value through income or expense), 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.

(c) Derivatives used for trading purposes

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

(10) Financial guarantee contracts

Other financial guarantees, in respect of intra-group funding and the pension deficit in respect of the former Britannia Pension Scheme, between the Group and its subsidiaries are treated as insurance contracts in accordance with IFRS 4 (Insurance Contracts (2004)). In accordance with the standard, the recognised insurance liability is assessed based on the current estimate of forecast future cash flows. If this highlights that the liability is inadequate, the liability is increased and the corresponding charge taken through the income statement.

(11) 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% to 2.5% per annum
Short leasehold buildings	life of lease
Equipment	10% to 33.3% per annum
Vehicles	25% per annum

All items of property, plant and equipment are reviewed for indications of impairment on a regular basis and at each balance sheet date. Any impairment identified would be charged to the income statement.

Basis of preparation and significant accounting policies continued
For the year ended 31 December 2011

Significant accounting policies continued

(12) Intangible assets

(a) Computer software

Computer software is stated at cost less cumulative amortisation and impairment. 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 up to a maximum of seven years.

(b) Other intangible assets

Other intangible assets are stated at cost less cumulative amortisation and impairment. Amortisation is charged over the useful life of the asset. For core systems, such as core deposit intangibles, a review of the asset's useful life is carried out and a maximum useful life of up to ten years is applied.

(13) Goodwill

All business combinations are accounted for by applying the purchase method. Goodwill represents amounts arising on acquisition of subsidiaries, associates and joint ventures and represents the difference between the cost of the acquisition and the fair value of the identifiable assets, liabilities and contingent liabilities acquired.

If a business combination is achieved without transfer of consideration, the amount of goodwill is calculated by reference to the fair value of the Group's interest in the acquiree using a valuation technique. The technique involves assessing the future net profit of the acquiree and then discounting using a rate that reflects current market assessment of the time value of money and risks specific to the acquiree.

Goodwill is stated at cost less any accumulated impairment losses. Goodwill is not amortised but is tested for impairment on an annual basis. Where impairment is required, the amount is recognised in the income statement and cannot be subsequently reversed.

(14) Leases

(a) Overview

The Group enters into leases for land and buildings and operating leases for vehicles.

Leases for land and buildings are split between leases for the land and leases for the buildings for accounting purposes only. The leases are separately assessed as to whether they are finance or operating leases.

The Group policy is to provide for the minimum future lease payments on buildings that it does not currently use, net of expected rental income from sub-leases.

(b) Assets leased to customers

All leases of assets to customers are finance leases. Income from assets leased to customers is credited to the income statement based on a pattern reflecting a constant periodic rate of return on the net investment in the lease.

(c) Assets leased from third parties

i) Finance leases

Finance lease assets are initially recorded at the lower of fair value and the present value of the minimum lease payments, and subsequently in accordance with the relevant policy for the underlying asset. An equal liability is recorded in other liabilities. Interest is allocated to the lease payments so as to record a constant periodic rate of charge on the outstanding liability.

ii) Operating leases

Operating lease payments are charged to the income statement on a straight line basis over the term of the lease and the asset is not recognised on the balance sheet.

(15) Cash and cash equivalents

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

(16) Income tax

(a) Overview

Tax on the income statement for the year comprises current and deferred tax, which is recognised in the income statement except to the extent that it relates to items recognised directly in equity, in which case it is recognised in the statement of comprehensive income.

(b) Current tax

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

(c) Deferred tax

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

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

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.

Significant accounting policies continued

(17) Pension costs

(a) Defined contribution basis

With effect from 6 April 2006, the 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) the assets of which are held in a separate fund administered by trustees. The Group's de facto participation level is on a defined contribution basis, as it pays fixed sums into the fund on a regular basis. This level of participation is required because the PACE defined benefit 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 PACE's 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.

(b) Former Britannia Building Society pension scheme

Following the transfer of engagements of Britannia Building Society, the Britannia defined benefit pension scheme transferred to the Co-operative Financial Services Management Services Limited (CFSMS), a fellow subsidiary undertaking of The Co-operative Banking Group. In accordance with policy 17.a, the pension costs in respect of this scheme are accounted for on a defined contribution basis and recognised as an expense in the income statement as incurred.

(18) Foreign currency

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

(19) Investments in Group undertakings

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

(20) Provisions for liabilities and charges

A provision is recognised in the balance sheet if the Group 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.

(21) 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 Co-operative Group and its subsidiaries including the Bank. Once these profit based payments are approved by the Co-operative Group Limited, the Bank is recharged an amount which reflects its eligible products' contribution to the overall Co-operative Group member dividend.

Risk management

For the year ended 31 December 2011

All the amounts are stated in £m unless otherwise indicated

The Co-operative Banking Group (the Banking Group) companies, including Co-operative Insurance Society Limited, CIS General Insurance Limited and The Co-operative Bank plc, have a common Board composition.

The Banking Group has developed and implemented a common governance and organisation structure, which supports all the Boards within the Banking Group.

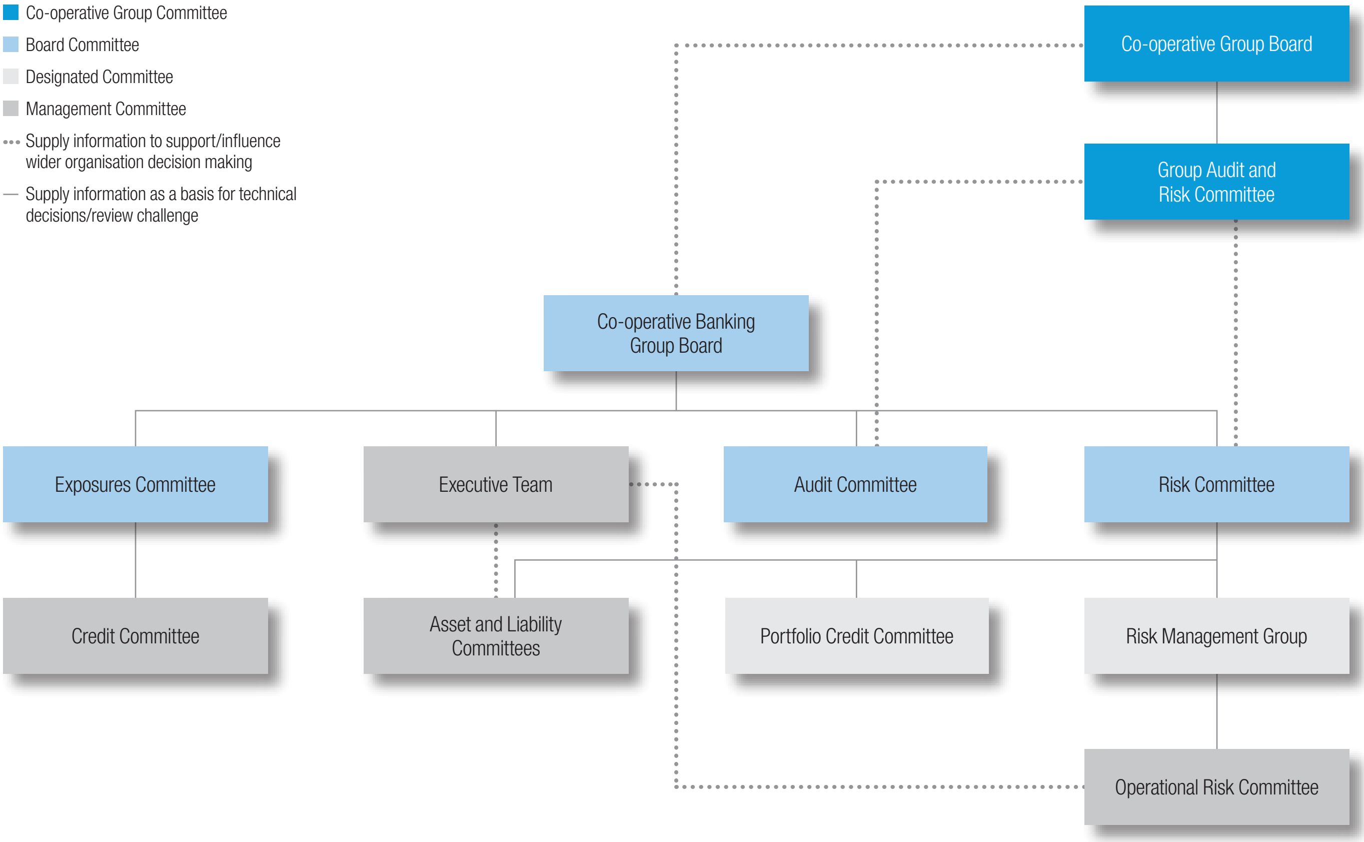
The Banking Group Board is responsible for approving the Banking Group strategy, its principal markets and the level of acceptable risks articulated through its statement of risk appetite. It is also responsible for overall corporate governance which includes ensuring that there is an adequate system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

The Board has established Board committees and senior management committees to:

- oversee the risk management process;
- identify the key risks facing the business; and
- assess 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



Risk management structure continued

Risk management committees

The Banking Group's Board delegates authority to the Banking Group's Risk 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.

Risk Committee (RC): this committee is responsible for the oversight of the adequacy of capital for all risks (technical, operational and business model and external) across the Banking Group. This includes:

- operation of mandates and limits and any breaches thereof;
- risk management policy approval;
- risk management information reporting and integrity of relevant data;
- identification and measurement of risk;
- risk and portfolio exposure management strategy;
- adequacy of the risk mitigation process;
- review and discussion of risk issues identified as a result of internal audit work; and
- review and challenge of the impact assessment of the strategic plan on the risk and capital profile.

Audit Committee (AC): this committee provides oversight on financial reporting, internal control, regulatory compliance, external and internal audit.

Exposures Committee: this committee ensures that non-executive directors are actively involved in major credit decisions (including sanctioning large counterparty transactions), monitors large exposures and problem loans as well as reviewing the adequacy of individual credit provisions.

Executive Team: the Executive Team manages the business in line with the Board risk appetite statement. It also maintains oversight of risk management processes and management information.

Risk and capital management sub-committees

Portfolio Credit Committee (PCC): this committee reports to RC and is chaired by the Banking Risk Officer. It is responsible for defining the Banking Group's credit risk appetite; providing oversight and timely action in relation to credit risk management; monitoring, challenging and approving changes to Basel rating systems; and reviewing lending and arrears policies.

Asset and Liability Committees (ALCO): these committees are management committees of the Board which are chaired by the Chief Financial Officer. They are primarily responsible for overseeing the management of market, liquidity and funding risks. They also advise on capital utilisation and the composition and sourcing of adequate capital.

Risk Management Group (RMG): this committee reports to RC and is chaired by the Chief Risk Officer. Its purpose is to provide a mechanism to ensure that the Banking Group's risk management is reviewed, challenged, approved (with escalation to RC where required) and embedded within the Banking Group. The committee also monitors all significant and emerging risks, and oversees the development and implementation of stress testing and risk appetite across the Banking Group.

Credit Committee: this committee is chaired by the Banking Risk Officer. The chair has delegated authority for approving credit facilities within approved strategies and delegated authorities.

Operational Risk Committee (ORC): this committee reports into RMG and is chaired by the Director of Specialist Risk Services. It monitors significant operational risks and controls as well as the management actions taken to mitigate them to an acceptable level or transfer them. This includes business continuity arrangements and insurance cover to protect the Banking Group's business. Capital requirements in relation to operational risk are monitored by the RC.

There is also a framework of sector specific management committees carrying out the following roles:

- supporting risk and capital management;
- implementing changes in business strategy;
- optimising performance;
- monitoring adherence to and setting of policy; and
- developing management information and training.

Risk management continued
For the year ended 31 December 2011
All the amounts are stated in £m unless otherwise indicated

Group significant risks

The Group's significant risks arise in five broad categories:

Risk type	Definition	Page
1. Credit risk	Credit risk is the current or prospective risk to earnings and capital arising from a borrower's failure to meet the terms of any contract with the Group or their failure to perform as agreed.	48
2. Liquidity risk	Liquidity risk is the risk that the Group's resources will prove inadequate to meet its commitments. It arises from the mismatch of timings of cash flows generated from the Banking Group's assets and liabilities (including derivatives).	64
3. Market risk	Market risk is the risk relating to changes in market prices of financial instruments, execution of customer and interbank business and proprietary trading. The majority of the Group's market risk arises from changes in interest rates.	67
4. Operational risk	Operational risk is 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.	69
5. Additional risks	Additional risks cover any non-operational risks as well as exposure to material loss due to the Banking Group being unable to meet its capital/liquidity/profit targets in line with approved risk appetite.	69

1. Credit risk
1.1 Overview
Credit risk is an integral part of our business activities and is inherent in both 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, securities borrowing and lending transactions).

All authority to take credit risk derives from the Banking Group's Board. This authority is delegated to the Chief Executive and then on to other individuals. The level of credit risk authority delegated depends on seniority and experience, and varies according to the quality of the counterparty, associated security or collateral held.

1.2 Credit risk policies
The credit risk policies are approved annually by the RC. The policies determine the criteria for the management of:

- credit risk associated with retail, corporate and wholesale segments (including securitisation, market exposures and credit management standards);
- country, sector and counterparty limits;
- risk appetites; and
- delegated authorities.

1.2.1 Retail credit risk
The Group's policy on retail secured and unsecured credit is to establish credit criteria that determine the balance between volume growth (generating higher income) and higher arrears and losses, so as to ensure the return is commensurate with the Group's risk appetite and strategic objectives. Retail credit risk related decisions are based on a combination of defined lending policies and the use of bespoke scorecards derived from historic data. Regular updates are provided to the PCC and RC on the performance of the portfolios.

1.2.2 Corporate credit risk
The Group's corporate sector policy is to maintain a broad spread of exposures across sectors which reflect the Group'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. The PCC and RC receive regular reports on the performance of the portfolio. The Exposures Committee receives regular reports on lending facilities, bad debt provisions and the management of problem loans.

1.2.3 Wholesale credit risk
The Group's credit risk framework for wholesale markets has, 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, dependent on Internal Rating Grade and associated Probability of Default (PD), to approve limits to individual counterparties within the parameters established by the credit risk policy. The RC 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.

1.3 Credit exposure
1.3.1 Definitions
Impaired and past due but not impaired in the tables below are further defined in the following sections on retail and corporate credit risk and investment securities.

Within neither past due nor impaired, low risk has been defined as exposures where the PD is 1% or below over a one year time horizon for exposures on an internal ratings based (IRB) approach under Basel II, and strong/good/satisfactory categories for corporate exposures under the slotting approach. Medium to high risk has been defined as a PD of greater than 1% over a one year time horizon for exposure on IRB approach under Basel II and weak category for corporate exposures under the slotting approach.

Fair value adjustments represent lifetime expected credit losses on assets acquired on the merger of the Bank and Britannia Building Society on 1 August 2009 and are reviewed on a regular basis to ensure appropriate allocation and utilisation.

1. Credit risk continued

1.3.2 Analyses of credit exposure

The following analysis of credit exposure shows:

- carrying amounts by class of asset in the balance sheet;
- the gross credit exposure by class of asset (excluding allowance for losses and including credit commitments);
- the net credit exposure by class of asset (including both allowance for losses and credit commitments);
- an analysis of the net credit exposures by level of impairment or risk; and
- fair value adjustments.

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

Group	Loans and advances to banks	Loans and advances to customers	Investment securities loans and receivables	Investment securities available for sale	Investment securities fair value through income or expense	Derivative financial instruments	Total
2011							
Analysis of balance per note	14	15	16	16	16	17	
Gross balance	**2,006.5**	**34,058.0**	**807.6**	**3,465.5**	**343.1**	**975.8**	**41,656.5**
Less: allowance for losses	**–**	**(292.0)**	**(2.7)**	**(42.5)**	**–**	**–**	**(337.2)**
	2,006.5	**33,766.0**	**804.9**	**3,423.0**	**343.1**	**975.8**	**41,319.3**
Analysis of credit risk exposure							
Gross balance	**2,006.5**	**34,058.0**	**807.6**	**3,465.5**	**343.1**	**975.8**	**41,656.5**
Credit commitments	**40.6**	**4,858.7**	**–**	**–**	**–**	**–**	**4,899.3**
Gross credit risk exposure	**2,047.1**	**38,916.7**	**807.6**	**3,465.5**	**343.1**	**975.8**	**46,555.8**
Less: allowance for losses	**–**	**(292.0)**	**(2.7)**	**(42.5)**	**–**	**–**	**(337.2)**
Net credit risk exposure	**2,047.1**	**38,624.7**	**804.9**	**3,423.0**	**343.1**	**975.8**	**46,218.6**
Analysis of net credit risk exposure by level of impairment or risk							
Individually impaired							
90 days past due or evidence of impairment	**–**	**1,657.7**	**3.9**	**42.5**	**–**	**0.4**	**1,704.5**
Impairment recognised	**–**	**(114.1)**	**(2.7)**	**(42.5)**	**–**	**–**	**(159.3)**
	–	**1,543.6**	**1.2**	**–**	**–**	**0.4**	**1,545.2**
Collectively impaired							
Less than 90 days past due	**–**	**1,236.8**	**–**	**–**	**–**	**–**	**1,236.8**
90–179 days past due	**–**	**15.5**	**–**	**–**	**–**	**–**	**15.5**
180 days plus past due	**21.0**	**152.6**	**–**	**–**	**–**	**–**	**173.6**
Impairment recognised	**–**	**(177.9)**	**–**	**–**	**–**	**–**	**(177.9)**
	21.0	**1,227.0**	**–**	**–**	**–**	**–**	**1,248.0**
Past due but not impaired							
0–29 days past due	**–**	**272.4**	**–**	**–**	**–**	**–**	**272.4**
30–59 days past due	**–**	**87.3**	**–**	**–**	**–**	**–**	**87.3**
60–89 days past due	**–**	**50.7**	**–**	**–**	**–**	**–**	**50.7**
	–	**410.4**	**–**	**–**	**–**	**–**	**410.4**
Neither past due nor impaired							
Low risk	**2,000.8**	**31,579.5**	**768.4**	**3,334.4**	**343.1**	**970.6**	**38,996.8**
Medium to high risk	**41.7**	**4,260.6**	**55.1**	**88.6**	**–**	**4.8**	**4,450.8**
	2,042.5	**35,840.1**	**823.5**	**3,423.0**	**343.1**	**975.4**	**43,447.6**
Fair value adjustments	**(16.4)**	**(396.4)**	**(19.8)**	**–**	**–**	**–**	**(432.6)**
	2,047.1	**38,624.7**	**804.9**	**3,423.0**	**343.1**	**975.8**	**46,218.6**

Risk management continued
For the year ended 31 December 2011
All the amounts are stated in £m unless otherwise indicated

1. Credit risk continued

Group	Loans and advances to banks	Loans and advances to customers	Investment securities loans and receivables	Investment securities available for sale	Investment securities fair value through income or expense	Derivative financial instruments	Total
2010							
Analysis of balance per note	14	15	16	16	16	17	
Gross balance	2,394.1	35,199.9	1,930.3	3,029.4	28.7	975.6	43,558.0
Less: allowance for losses	–	(222.6)	(13.0)	(72.3)	–	–	(307.9)
	2,394.1	34,977.3	1,917.3	2,957.1	28.7	975.6	43,250.1
Analysis of credit risk exposure							
Gross balance	2,394.1	35,199.9	1,930.3	3,029.4	28.7	975.6	43,558.0
Credit commitments	176.0	4,717.7	–	–	–	–	4,893.7
Gross credit risk exposure	2,570.1	39,917.6	1,930.3	3,029.4	28.7	975.6	48,451.7
Less: allowance for losses	–	(222.6)	(13.0)	(72.3)	–	–	(307.9)
Net credit risk exposure	2,570.1	39,695.0	1,917.3	2,957.1	28.7	975.6	48,143.8
Analysis of net credit risk exposure by level of impairment or risk							
Individually impaired							
90 days past due or evidence of impairment	–	1,790.1	25.0	72.3	–	–	1,887.4
Impairment recognised	–	(64.4)	(8.5)	(72.3)	–	–	(145.2)
	–	1,725.7	16.5	–	–	–	1,742.2
Collectively impaired							
Less than 90 days past due	–	796.4	119.2	–	–	–	915.6
90–179 days past due	–	18.4	–	–	–	–	18.4
180 days plus past due	21.0	143.4	–	–	–	–	164.4
Impairment recognised	–	(158.2)	(4.5)	–	–	–	(162.7)
	21.0	800.0	114.7	–	–	–	935.7
Past due but not impaired							
0–29 days past due	–	240.1	–	–	–	–	240.1
30–59 days past due	–	118.7	–	–	–	–	118.7
60–89 days past due	–	178.7	–	–	–	–	178.7
	–	537.5	–	–	–	–	537.5
Neither past due nor impaired							
Low risk	2,565.5	31,997.2	1,831.1	2,946.2	28.7	975.6	40,344.3
Medium to high risk	–	5,112.8	–	10.9	–	–	5,123.7
	2,565.5	37,110.0	1,831.1	2,957.1	28.7	975.6	45,468.0
Fair value adjustments	(16.4)	(478.2)	(45.0)	–	–	–	(539.6)
	2,570.1	39,695.0	1,917.3	2,957.1	28.7	975.6	48,143.8

The impairment analysis of loans and advances to customers has been restated to show a consistent comparison to 2011 following the inclusion of assets subject to forbearance in impairment definitions.

1. Credit risk continued

Bank	Loans and advances to banks	Loans and advances to customers	Investment securities loans and receivables	Investment securities available for sale	Investment securities fair value through income or expense	Derivative financial instruments	Total
2011							
Analysis of balance per note	14	15	16	16	16	17	
Gross balance	**1,300.1**	**22,993.1**	**868.8**	**3,149.9**	**343.1**	**704.4**	**29,359.4**
Less: allowance for losses	**–**	**(258.1)**	**(2.7)**	**(42.5)**	**–**	**–**	**(303.3)**
	1,300.1	**22,735.0**	**866.1**	**3,107.4**	**343.1**	**704.4**	**29,056.1**
Analysis of credit risk exposure							
Gross balance	**1,300.1**	**22,993.1**	**868.8**	**3,149.9**	**343.1**	**704.4**	**29,359.4**
Credit commitments	**40.6**	**4,661.8**	**–**	**–**	**–**	**–**	**4,702.4**
Gross credit risk exposure	**1,340.7**	**27,654.9**	**868.8**	**3,149.9**	**343.1**	**704.4**	**34,061.8**
Less: allowance for losses	**–**	**(258.1)**	**(2.7)**	**(42.5)**	**–**	**–**	**(303.3)**
Net credit risk exposure	**1,340.7**	**27,396.8**	**866.1**	**3,107.4**	**343.1**	**704.4**	**33,758.5**
Analysis of net credit risk exposure by level of impairment or risk							
Individually impaired							
90 days past due or evidence of impairment	**–**	**418.2**	**3.9**	**42.5**	**–**	**0.4**	**465.0**
Impairment recognised	**–**	**(88.7)**	**(2.7)**	**(42.5)**	**–**	**–**	**(133.9)**
	–	**329.5**	**1.2**	**–**	**–**	**0.4**	**331.1**
Collectively impaired							
Less than 90 days past due	**–**	**295.1**	**–**	**–**	**–**	**–**	**295.1**
90–179 days past due	**–**	**15.5**	**–**	**–**	**–**	**–**	**15.5**
180 days plus past due	**21.0**	**152.6**	**–**	**–**	**–**	**–**	**173.6**
Impairment recognised	**–**	**(169.4)**	**–**	**–**	**–**	**–**	**(169.4)**
	21.0	**293.8**	**–**	**–**	**–**	**–**	**314.8**
Past due but not impaired							
0–29 days past due	**–**	**46.8**	**–**	**–**	**–**	**–**	**46.8**
30–59 days past due	**–**	**27.1**	**–**	**–**	**–**	**–**	**27.1**
60–89 days past due	**–**	**12.7**	**–**	**–**	**–**	**–**	**12.7**
	–	**86.6**	**–**	**–**	**–**	**–**	**86.6**
Neither past due nor impaired							
Low risk	**1,294.4**	**24,672.8**	**829.6**	**3,018.8**	**343.1**	**699.2**	**30,857.9**
Medium to high risk	**41.7**	**2,056.9**	**55.1**	**88.6**	**–**	**4.8**	**2,247.1**
	1,336.1	**26,729.7**	**884.7**	**3,107.4**	**343.1**	**704.0**	**33,105.0**
Fair value adjustments	**(16.4)**	**(42.8)**	**(19.8)**	**–**	**–**	**–**	**(79.0)**
	1,340.7	**27,396.8**	**866.1**	**3,107.4**	**343.1**	**704.4**	**33,758.5**

Risk management continued
For the year ended 31 December 2011
All the amounts are stated in £m unless otherwise indicated

1. Credit risk continued

Bank	Loans and advances to banks	Loans and advances to customers	Investment securities loans and receivables	Investment securities available for sale	Investment securities fair value through income or expense	Derivative financial instruments	Total
2010							
Analysis of balance per note	14	15	16	16	16	17	
Gross balance	1,728.6	24,055.4	1,999.8	2,693.7	28.7	704.7	31,210.9
Less: allowance for losses	–	(210.5)	(13.0)	(72.3)	–	–	(295.8)
	1,728.6	23,844.9	1,986.8	2,621.4	28.7	704.7	30,915.1
Analysis of credit risk exposure							
Gross balance	1,728.6	24,055.4	1,999.8	2,693.7	28.7	704.7	31,210.9
Credit commitments	176.0	4,576.3	–	–	–	–	4,752.3
Gross credit risk exposure	1,904.6	28,631.7	1,999.8	2,693.7	28.7	704.7	35,963.2
Less: allowance for losses	–	(210.5)	(13.0)	(72.3)	–	–	(295.8)
Net credit risk exposure	1,904.6	28,421.2	1,986.8	2,621.4	28.7	704.7	35,667.4
Analysis of net credit risk exposure by level of impairment or risk							
Individually impaired							
90 days past due or evidence of impairment	–	277.0	25.0	72.3	–	–	374.3
Impairment recognised	–	(52.3)	(8.5)	(72.3)	–	–	(133.1)
	–	224.7	16.5	–	–	–	241.2
Collectively impaired							
Less than 90 days past due	–	149.6	119.2	–	–	–	268.8
90–179 days past due	–	18.4	–	–	–	–	18.4
180 days plus past due	21.0	143.4	–	–	–	–	164.4
Impairment recognised	–	(158.2)	(4.5)	–	–	–	(162.7)
	21.0	153.2	114.7	–	–	–	288.9
Past due but not impaired							
0–29 days past due	–	50.7	–	–	–	–	50.7
30–59 days past due	–	39.4	–	–	–	–	39.4
60–89 days past due	–	29.0	–	–	–	–	29.0
	–	119.1	–	–	–	–	119.1
Neither past due nor impaired							
Low risk	1,900.0	25,546.7	1,900.6	2,610.5	28.7	704.7	32,691.2
Medium to high risk	–	2,430.2	–	10.9	–	–	2,441.1
	1,900.0	27,976.9	1,900.6	2,621.4	28.7	704.7	35,132.3
Fair value adjustments	(16.4)	(52.7)	(45.0)	–	–	–	(114.1)
	1,904.6	28,421.2	1,986.8	2,621.4	28.7	704.7	35,667.4

The impairment analysis of loans and advances to customers has been restated to show a consistent comparison to 2011 following the inclusion of assets subject to forbearance in impairment definitions.

1.4 Analysis of impaired assets and associated collateral
The following sections provide further analysis and disclosure of the Group's credit risk associated with:

- loans and advances to customers;
- investment securities; and
- loans and advances to banks.

1. Credit risk continued

1.4.1 Loans and advances to customers

1.4.1.1 How we oversee and control credit risk

The Credit Risk Control Unit (CRCU) provides an independent view of credit risk in order to support the business' decision making. CRCU does not directly benefit from decisions to extend credit. The CRCU provides risk oversight by virtue of its independence from the business management functions. The CRCU function is in house and is not outsourced.

CRCU is responsible for procedures across both retail and corporate, and performs the following tasks and responsibilities related to its role:

- design and implementation of risk assessment and rating systems;
- testing, validating, documenting and monitoring of risk assessment and rating systems;
- production and analysis of summary reports of risk assessment and rating systems;
- maintenance of lending policy and procedures, and upkeep of various returns and reporting requirements;
- monitoring system decision overrides and exceptions;
- benchmarking against third party data and vendor model sources;
- reviewing the risk criteria to ensure they remain predictive of risk;
- oversight of independent validation;
- development and monitoring of risk appetites; and
- liaison with FSA regarding proposed changes to rating systems and forecast regulatory capital levels.

On pages 54 to 61 the management of credit risk by portfolio is described covering:

- acquisition and account management;
- collateral;
- impairment assessment; and
- forbearance.

1.4.1.2 Assessment for impairment

The loan portfolios are periodically reviewed, usually once a month, to assess impairment. A loan will be deemed to be impaired where there is objective evidence that a loss event has occurred after recognition of an asset and by 31 December 2011. Further detail is provided in the following credit risk sections.

Once a loan is defined as impaired the provision will be calculated as the difference between the current carrying value of the asset (including fair value adjustments) and the expected future recovery, discounted at the loan's effective interest rate, taking into account the expected charge off rate and any supporting collateral. (Full details are contained in the significant accounting policies on page 41 and in the following credit risk sections.)

The following table analyses the gross balance by impairment classification for the Retail (secured and unsecured) and CABB (corporate, Platform and Optimum) business segments. It includes credit commitments, impairment provisions and fair value adjustments.

	Retail		CABB			
Group	**Secured**	**Unsecured**	**Corporate**	**Platform**	**Optimum**	**Total**
2011						
Individually impaired						
90 days past due or evidence of impairment	**68.7**	**–**	**710.0**	**5.0**	**874.0**	**1,657.7**
Impairment recognised	**(2.6)**	**–**	**(105.1)**	**(0.1)**	**(6.3)**	**(114.1)**
	66.1	**–**	**604.9**	**4.9**	**867.7**	**1,543.6**
Collectively impaired						
Less than 90 days past due	**195.7**	**52.6**	**290.4**	**7.9**	**690.2**	**1,236.8**
90–179 days past due	**–**	**15.5**	**–**	**–**	**–**	**15.5**
180 days plus past due	**–**	**151.5**	**1.1**	**–**	**–**	**152.6**
Impairment recognised	**(0.4)**	**(163.3)**	**(12.2)**	**–**	**(2.0)**	**(177.9)**
	195.3	**56.3**	**279.3**	**7.9**	**688.2**	**1,227.0**
Past due but not impaired						
0–29 days past due	**39.9**	**6.5**	**0.4**	**4.6**	**221.0**	**272.4**
30–59 days past due	**27.1**	**–**	**–**	**4.0**	**56.2**	**87.3**
60–89 days past due	**9.8**	**–**	**11.4**	**1.5**	**28.0**	**50.7**
	76.8	**6.5**	**11.8**	**10.1**	**305.2**	**410.4**
Neither past due nor impaired						
Low risk	**13,972.1**	**2,585.2**	**9,285.7**	**1,467.7**	**4,268.8**	**31,579.5**
Medium to high risk	**230.0**	**1,129.6**	**1,067.0**	**87.1**	**1,746.9**	**4,260.6**
	14,202.1	**3,714.8**	**10,352.7**	**1,554.8**	**6,015.7**	**35,840.1**
Fair value adjustments	**(6.7)**	**–**	**(251.5)**	**–**	**(138.2)**	**(396.4)**
	14,533.6	**3,777.6**	**10,997.2**	**1,577.7**	**7,738.6**	**38,624.7**

Risk management continued
For the year ended 31 December 2011
All the amounts are stated in £m unless otherwise indicated

1. Credit risk continued

Group	Retail Secured	Retail Unsecured	Corporate	CABB Platform	Optimum	Total
2010						
Individually impaired						
90 days past due or evidence of impairment	56.3	–	609.4	6.3	1,118.1	1,790.1
Impairment recognised	(3.0)	–	(55.8)	–	(5.6)	(64.4)
	53.3	–	553.6	6.3	1,112.5	1,725.7
Collectively impaired						
Less than 90 days past due	100.4	49.2	–	4.7	642.1	796.4
90–179 days past due	–	18.4	–	–	–	18.4
180 days plus past due	–	142.9	0.5	–	–	143.4
Impairment recognised	–	(158.2)	–	–	–	(158.2)
	100.4	52.3	0.5	4.7	642.1	800.0
Past due but not impaired						
0–29 days past due	44.9	5.7	0.1	3.6	185.8	240.1
30–59 days past due	39.0	–	0.4	3.8	75.5	118.7
60–89 days past due	15.3	–	126.4	2.7	34.3	178.7
	99.2	5.7	126.9	10.1	295.6	537.5
Neither past due nor impaired						
Low risk	15,303.6	2,782.5	8,772.6	808.4	4,330.1	31,997.2
Medium to high risk	368.8	1,203.2	1,418.1	74.1	2,048.6	5,112.8
	15,672.4	3,985.7	10,190.7	882.5	6,378.7	37,110.0
Fair value adjustments	(7.8)	–	(265.4)	–	(205.0)	(478.2)
	15,917.5	4,043.7	10,606.3	903.6	8,223.9	39,695.0

1.4.1.3 Secured residential credit risk
Acquisition and account management

Secured loans are mortgages originated directly to customers via branches, telephone and the internet in the retail business and via intermediaries in the Platform business. In 2011 55% (2010: 79%) of mortgages were originated through the retail business and 45% (2010: 21%) through Platform. Completions of retail and Platform prime mortgages have fallen whilst completions of buy to let mortgages originated through Platform have substantially increased.

Retail mortgages are prime residential mortgages and include loans originated via both Britannia and Co-operative Bank branded sales channels.

Platform originates a combination of prime and ‘almost prime’ residential mortgages together with buy to let loans.

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

Loan repayment methods may be capital and interest, where the loan is repaid over the term of the loan, or interest only, where the capital element of the loan is normally repaid at the end of the term.

The table below shows residential mortgage completions analysed by loan to value (LTV) and repayment method:

	2011 Amount advanced	**2011 Average LTV %**	**2011 % Interest only**	2010 Amount advanced	2010 Average LTV %	2010 % Interest only
Retail prime	**790.5**	**57.9**	**11.8**	2,444.3	60.0	20.9
Platform prime	**182.1**	**66.1**	**22.1**	526.4	66.4	25.7
Total prime	**972.6**	**59.3**	**13.0**	2,970.7	61.0	21.5
Buy to let	**446.3**	**62.6**	**83.0**	68.7	59.5	87.5
Almost prime	**10.3**	**52.9**	**13.4**	39.2	54.5	23.9
Self certified	**–**	**–**	**–**	0.5	54.3	100.0
Total completions	**1,429.2**	**60.4**	**30.4**	3,079.1	60.9	22.9

The risk in the portfolio is re-evaluated monthly using internally developed behavioural scorecards, to assess the probability of a borrower defaulting in the following 12 months and to reflect any changes in the value of collateral. The revaluation will determine the amount of capital required to be held for individual loans.

1. Credit risk continued

The table below shows the residential mortgages gross customer balances analysed by LTV banding:

2011	Retail secured	Platform	Optimum	Total
Less than 50%	**5,524.2**	**182.5**	**484.0**	**6,190.7**
50% to 60%	**1,929.0**	**228.8**	**372.7**	**2,530.5**
60% to 70%	**2,001.3**	**416.7**	**673.0**	**3,091.0**
70% to 80%	**2,088.9**	**474.5**	**1,067.7**	**3,631.1**
80% to 90%	**1,761.9**	**112.6**	**1,604.9**	**3,479.4**
90% to 100%	**647.1**	**4.7**	**1,696.2**	**2,348.0**
Greater than 100%	**418.4**	**2.3**	**2,035.7**	**2,456.4**
	14,370.8	**1,422.1**	**7,934.2**	**23,727.1**

2010	Retail secured	Platform	Optimum	Total
Less than 50%	6,221.2	118.7	523.4	6,863.3
50% to 60%	2,124.3	131.5	406.6	2,662.4
60% to 70%	2,117.0	254.8	728.6	3,100.4
70% to 80%	2,281.1	306.5	1,196.5	3,784.1
80% to 90%	1,836.0	88.3	1,781.4	3,705.7
90% to 100%	735.5	3.8	1,827.4	2,566.7
Greater than 100%	482.1	0.1	1,981.2	2,463.4
	15,797.2	903.7	8,445.1	25,146.0

The table below shows the gross customer balances for residential mortgages analysed by asset class:

	2011			2010		
	Exposure	**Average LTV %**	**% Interest only**	Exposure	Average LTV %	% Interest only
Prime residential	**15,745.9**	**43.5**	**25.1**	17,126.3	43.3	25.4
Buy to let	**2,881.3**	**76.1**	**90.5**	2,557.0	77.5	90.6
Self-certified	**2,228.7**	**76.6**	**77.3**	2,386.2	75.7	77.2
Almost prime	**997.1**	**89.5**	**67.1**	1,058.7	89.1	68.2
Non-conforming	**1,874.1**	**77.1**	**65.7**	2,017.8	76.7	65.7
	23,727.1	**52.7**	**42.9**	25,146.0	52.0	42.0

Collateral

All mortgages are secured by a first charge over the property being purchased or remortgaged. Valuation of the property is normally assessed by a RICS certified valuer from the Group's approved panel of valuers. For low LTV remortgages, valuation may be assessed through the use of an automated valuation model (AVM). Performance of AVMs is monitored on a regular basis to ensure their ongoing accuracy.

It is not normal practice to reassess the valuation of collateral unless further lending is being considered, or the property has been repossessed, but on a quarterly basis the valuation will be restated using a regional property price index.

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

	2011			2010		
	Impaired	**Non-impaired**	**Total**	Impaired	Non-impaired	Total
Exposure	**1,853.6**	**21,873.5**	**23,727.1**	2,025.8	23,120.2	25,146.0
Collateral	**1,785.8**	**21,751.2**	**23,537.0**	1,962.7	23,004.6	24,967.3
Cover	**96.3%**	**99.4%**	**99.2%**	96.9%	99.5%	99.3%

Risk management continued
For the year ended 31 December 2011
All the amounts are stated in £m unless otherwise indicated

1. Credit risk continued
Impairment
Loans and advances to customers are considered impaired where there is objective evidence of a loss event having occurred after the original advance. This indicates that the Group may be unable to collect all principal and interest outstanding according to the contractual terms of the agreements.

Objective evidence of a loss event is considered to have occurred when:

- arrears outstanding are equivalent to 90 days or more; or
- the loan is subject to litigation; or
- the loan has passed its due date for repayment but has not been repaid; or
- the value of the collateral on a roll up mortgage has reduced below the loan balance outstanding; or
- the loan is identified as being subject to forbearance.

In addition, a provision may be held when:

- the loan is in arrears by less than 90 days; or
- there has been a material deterioration in the borrower's external credit score in the last 12 months.

Loans meeting the latter criteria are collectively assessed for impairment when a loss is expected in the event of repossession.

Loans that have arrears of less than 90 days, but when a loss is not expected, are defined as past due but not impaired.

Impairment definitions were updated in the second half of 2011 to include mortgages subject to forbearance, or where collateral on roll up mortgages has reduced below the loan balance outstanding and mortgages which have past the due date for repayment but have not been repaid. These changes have resulted in a one off increase in impairment provisions of £2.8m.

The table below shows:

- impaired customer balances as a percentage of gross customer balances; and
- impairment coverage, ie impairment provisions and fair value adjustments as a percentage of impaired customer balances.

	2011			2010		
	Retail secured	**Platform**	**Optimum**	Retail secured	Platform	Optimum
Gross loans and advances to customers	**14,379.5**	**1,423.0**	**7,745.9**	15,830.2	897.7	8,138.5
Fair value adjustments	**6.7**	**–**	**138.2**	7.8	–	205.0
Other accounting adjustments	**(15.4)**	**(0.9)**	**50.1**	(40.8)	6.0	101.6
Gross customer balances	**14,370.8**	**1,422.1**	**7,934.2**	15,797.2	903.7	8,445.1
Impaired customer balances	**264.9**	**12.9**	**1,575.8**	237.7	11.1	1,777.1
Impaired as a % of gross customer balances	**1.8%**	**0.9%**	**19.9%**	1.5%	1.2%	21.0%
Credit protection						
Impairment provisions	**3.0**	**0.1**	**8.3**	3.0	–	5.6
Fair value adjustments	**6.7**	**–**	**138.2**	7.8	–	205.0
	9.7	**0.1**	**146.5**	10.8	–	210.6
Credit protection as a % of impaired customer balances	**3.7%**	**0.8%**	**9.3%**	4.5%	0.0%	11.9%

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

- arrangements to repay outstanding arrears over a period of time, by making payments above the contractual amount. The loan will be deemed impaired, and arrears will continue to be reported, until the arrears have been cleared in full;
- short term concessions, where the borrower is allowed to make reduced repayments (or, in exceptional circumstances, no repayments) on a temporary basis to assist with a short term financial hardship. In these cases the shortfall on the repayments will accrue as arrears and the loan will be deemed to be impaired. Note that this treatment is distinct from a 'payment holiday', which is allowed as part of a customer's flexible mortgage contract. Payment holidays would not knowingly be allowed for customers experiencing financial hardship. However, in the absence of evidence to the contrary, loans that have had a payment holiday in the last two years have been treated as impaired within the year end accounts;
- temporary conversion of a mortgage to interest only repayments. This treatment has sometimes been used as an alternative to a concession for mortgage borrowers experiencing short term financial hardship. The capital repayments due in this period are added to the capital balance outstanding on the mortgage. These loans are identified as impaired;
- a permanent switch from capital and interest repayments to interest only repayments, provided the borrower declares they have an alternative means of repaying the capital at the end of the term. As the borrower is not required to prove they have an alternative repayment vehicle in place, there is a risk that borrowers have switched purely to reduce their repayments and may not in reality have a repayment vehicle. Consequently all loans that have switched to interest only after the origination of the loan are treated as impaired;
- an extension to the term of the mortgage to reduce the borrower's repayments. Term extensions may be offered proactively to a borrower experiencing financial hardship, or in response to a borrower's request. Loans that have had a term extension in the last two years are considered as impaired; and
- capitalisation, where outstanding arrears are added to the capital value of the loan to be repaid over the remaining term. This is only considered where it is appropriate for the borrower's circumstances, and where the borrower has been performing for at least six months. During 2011, 90 (2010: 605) loans had arrears capitalised of £0.3m (2010: £1.0m). These loans are not treated as impaired unless the borrower meets another impairment trigger (eg misses a mortgage payment).

1. Credit risk continued

The underlying basis for the calculation of residential mortgage impairment provisions remains unchanged. Mortgages subject to forbearance, once classified as impaired, are treated in the same way as all other impaired mortgages in the impairment provisions calculations.

The table below analyses retail mortgage forbearance by concession allowed:

	2011		2010	
	Exposure	**Impairment**	Exposure	Impairment
Arrangements	**546.6**	**26.0**	562.9	31.1
Concessions	**7.2**	**0.1**	6.5	0.1
Payment holidays	**175.8**	**–**	173.3	–
Interest only switches	**584.6**	**1.1**	569.4	–
Term extensions	**147.3**	**0.1**	176.7	–
Capitalisations	**9.8**	**–**	19.0	–
	1,471.3	**27.3**	1,507.8	31.2

1.4.1.4 Unsecured retail credit risk

Acquisition and account management

The Group offers unsecured lending through fixed repayment loans, credit cards and overdrafts. Borrowers are assessed using a combination of credit scoring and policy rules to ensure that expected delinquency levels are within the risk appetite of the business and deliver an appropriate level of return. Credit cards and overdrafts are subject to ongoing account management to increase or decrease credit limits and manage over limit authorisations.

The risk in the portfolio is re-evaluated monthly using internally developed behavioural scorecards to determine the amount of capital required to be held for individual loans.

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

	2011	2010
Loans	**751.0**	833.0
Credit cards	**2,841.4**	3,042.8
Overdrafts	**377.0**	363.5
	3,969.4	4,239.3

Impairment

Credit cards are identified as impaired immediately if the borrower fails to make the minimum payment by the due date.

Loans are identified as impaired if a monthly payment has not been made 15 days after it was due.

An overdraft is defined as impaired if the account has been overdrawn in excess of any agreed limit for 15 days, or if the agreed overdraft has expired but the account remains overdrawn.

Accounts identified as impaired will be segmented according to the number of days that the loan has been impaired. The provision for each segment is based on the probability of charge off. An account is charged off when all economical avenues to recover the debt have been exhausted.

The table below shows:

- gross customer balances (excluding commitments);
- impaired customer balances as a percentage of gross customer balances; and
- impairment coverage, ie impairment provisions and fair value adjustments as a percentage of impaired customer balances.

	2011	2010
Gross loans and advances to customers	**1,518.1**	1,613.1
Other accounting adjustments	**17.5**	41.2
Gross customer balances	**1,535.6**	1,654.3
Impaired customer balances	**296.5**	308.4
Impaired as a % of gross customer balances	**19.3%**	18.6%
Credit protection		
Impairment provisions	**163.3**	158.2
Credit protection as a % of impaired customer balances	**55.1%**	51.3%

Risk management continued
For the year ended 31 December 2011
All the amounts are stated in £m unless otherwise indicated

1. Credit risk continued
Forbearance
Where a borrower is unable to clear their arrears in full, the Group will endeavour to agree an arrangement with the borrower to repay the outstanding arrears over a period of time, or may agree to accept payments of less than the contractual amount during a period of temporary financial hardship. In these instances the loan continues to be reported as impaired until the arrears are cleared in full. Arrangements can be made directly with the customer or through a third party who they have chosen to represent them.

A negative disposable income account is where the customer's current financial situation means they are unable to make any monthly payments to their unsecured creditors. In such circumstances the Group may refrain from further action during a period of financial hardship. The customer's circumstances will be reviewed on a regular basis, with a view to resolving the situation once those circumstances improve. These loans continue to be reported as impaired, and will have a higher dedicated provision rate than the standard provisioning rates.

'Regular payers' are defined as accounts that are greater than 90 days in arrears and are making regular payments (irrespective of whether they are on a formal arrangement or not). These accounts continue to be reported as impaired, but the provision rate will reflect the specific probability of charge off for these accounts.

In 2010, the provisioning methodology used re-ages, rather than the 'regular payers' treatment criteria used for 2011. Re-ages applied only to accounts with early stage arrears, as opposed to 'regular payers' which includes all arrears stages.

The table below shows current exposure and provision by treatment type:

	2011		2010	
	Current exposure	**Impairment**	Current exposure	Impairment
Regular payers	**93.5**	**70.2**	–	–
Re-ages	**–**	**–**	23.9	11.4
Standard collections	**41.5**	**23.1**	117.1	88.3
Negative disposable income	**16.9**	**15.7**	10.5	10.0
Fraud	**5.3**	**4.8**	3.4	3.3
Individual voluntary arrangements	**55.5**	**49.5**	50.8	45.2
	212.7	**163.3**	205.7	158.2

When all internal activities to rehabilitate the borrower have been exhausted, accounts are charged off and referred to Debt Collection Agencies (DCAs) to seek full recovery of the debt. The loan balance remaining on balance sheet reflects the amount expected to be recovered.

	2011			2010		
	Original balance	**Charged off**	**Current exposure**	Original balance	Charged off	Current exposure
DCAs	**97.0**	**90.0**	**7.0**	116.4	111.1	5.3

1.4.1.5 Corporate credit risk
Acquisition and account management
New lending is approved by experienced staff within the centrally based credit underwriting team, independent from income generation. Lending discretions are based on the risk profile of the customer and the amount of exposure. The lending discretions of the Banking Risk Officer, the Chief Executive and the Exposure Committee are operated to sanction the largest credit applications.

The credit underwriting team uses the relevant rating systems and other tools to analyse the underlying business and the counterparty's management to assess the risk of each lending proposition and its ability to repay the borrowing. Other factors considered include the potential impact of economic changes, the financial stability of the counterparty and its ability to withstand such change.

The Group's corporate sector policy is to maintain a broad sectoral spread of exposures which reflect the Group'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.

The PCC and the RC receive 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 management of problem loans.

The following table shows the distribution of the corporate and business banking gross customer balances (including commitments) by sector and risk grade, where PD grades have been mapped to regulatory slotting categories for ease of interpretation in this report.

1. Credit risk continued

2011	Unrated	Strong	Good	Satisfactory	Weak	Default	Total
Accommodation, food and licensed services	**319.5**	**60.9**	**53.3**	**31.4**	**1.5**	**110.1**	**576.7**
Care	**177.0**	**29.1**	**19.3**	**26.9**	**2.9**	**–**	**255.2**
Education	**68.6**	**46.1**	**11.6**	**0.8**	**–**	**–**	**127.1**
Financial services	**82.1**	**54.1**	**40.3**	**4.8**	**–**	**3.7**	**185.0**
Football clubs	**–**	**41.6**	**–**	**0.9**	**15.1**	**5.7**	**63.3**
Housing associations	**1,132.8**	**–**	**0.5**	**–**	**–**	**–**	**1,133.3**
Manufacturing	**92.4**	**15.9**	**40.5**	**20.9**	**24.4**	**1.6**	**195.7**
Motor trade and garages	**34.1**	**39.9**	**22.8**	**1.9**	**8.6**	**4.0**	**111.3**
PFI	**0.8**	**–**	**1,260.8**	**–**	**14.6**	**–**	**1,276.2**
Professional services	**61.6**	**26.6**	**27.4**	**7.9**	**3.3**	**4.5**	**131.3**
Property and construction:							
Commercial investment	**123.2**	**174.4**	**1,466.4**	**767.7**	**584.4**	**562.7**	**3,678.8**
Residential investment	**11.0**	**59.1**	**229.0**	**116.3**	**24.1**	**154.7**	**594.2**
Commercial construction	**6.8**	**9.1**	**112.5**	**123.0**	**24.0**	**11.1**	**286.5**
Residential development	**1.7**	**1.8**	**65.3**	**35.1**	**13.4**	**3.9**	**121.2**
Public sector entities	**198.0**	**–**	**–**	**–**	**–**	**–**	**198.0**
Renewable energy	**437.5**	**–**	**–**	**–**	**–**	**10.3**	**447.8**
Retail and wholesale trade	**107.4**	**335.2**	**69.9**	**19.5**	**1.0**	**0.3**	**533.3**
Services	**460.3**	**103.3**	**50.5**	**60.8**	**8.4**	**21.6**	**704.9**
Transport, storage and communication	**168.5**	**53.5**	**11.0**	**7.4**	**15.0**	**23.9**	**279.3**
Utilities	**74.5**	**0.8**	**1.5**	**10.5**	**–**	**0.6**	**87.9**
Business banking	**0.8**	**32.6**	**7.5**	**3.3**	**0.9**	**0.5**	**45.6**
Other	**11.9**	**1.1**	**1.9**	**4.1**	**–**	**2.1**	**21.1**
	3,570.5	**1,085.1**	**3,492.0**	**1,243.2**	**741.6**	**921.3**	**11,053.7**

2010	Unrated	Strong	Good	Satisfactory	Weak	Default	Total
Accommodation, food and licensed services	185.9	54.2	29.5	36.2	2.0	26.0	333.8
Care	115.1	13.0	45.6	18.7	3.1	–	195.5
Education	53.7	36.1	11.1	1.2	–	–	102.1
Financial services	49.2	45.9	52.5	4.0	7.0	2.8	161.4
Football clubs	0.1	–	44.4	16.0	0.7	11.9	73.1
Housing associations	1,118.6	–	–	–	–	–	1,118.6
Manufacturing	95.3	12.4	37.6	23.2	22.5	8.4	199.4
Motor trade and garages	33.9	22.2	24.9	8.7	9.9	0.3	99.9
PFI	3.5	3.9	1,140.3	–	–	–	1,147.7
Professional services	71.3	25.0	16.8	20.2	4.1	4.4	141.8
Property and construction:							
Commercial investment	165.2	205.7	1,998.2	422.7	409.7	458.9	3,660.4
Residential investment	22.4	100.7	286.3	85.9	164.0	98.4	757.7
Commercial construction	2.6	9.6	150.3	92.6	33.5	17.6	306.2
Residential development	1.3	1.7	66.7	42.6	12.8	2.2	127.3
Public sector entities	185.4	–	–	–	–	–	185.4
Renewable energy	236.3	–	–	–	–	–	236.3
Retail and wholesale trade	102.4	161.7	276.8	33.2	0.3	0.3	574.7
Services	406.3	83.8	71.3	69.2	9.7	29.9	670.2
Transport, storage and communication	163.6	65.1	33.8	3.1	17.3	–	282.9
Utilities	60.1	–	–	0.6	–	0.6	61.3
Business banking	1.3	32.6	7.3	4.0	1.4	0.5	47.1
Other	9.9	1.9	1.8	4.4	–	2.1	20.1
	3,083.4	875.5	4,295.2	886.5	698.0	664.3	10,502.9

Risk management continued
For the year ended 31 December 2011
All the amounts are stated in £m unless otherwise indicated

1. Credit risk continued
Collateral
The Group uses guarantees and collateral to mitigate credit risk. Collateral is regularly revalued and guarantees are reviewed to ensure continuing effectiveness.

Property collateral for corporate lending is categorised as security for property development or investment customers (ie 'property' lending) or owner occupied premises to secure mainstream loan and overdraft facilities. For general lending, in addition to taking charges over property assets owned by the Company, other security is taken in modest proportion to the total portfolio. This includes debentures or floating charges (supported by tangible security, where appropriate, including property, life policies and stocks and shares) and cash cover.

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

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

The table below analyses the fair value of the property collateral held against assets in the property and construction sectors:

	2011		2010	
	Exposure	**Collateral**	Exposure	Collateral
Individually impaired	**732.4**	**386.3**	577.0	357.7
On watchlist	**1,252.6**	**1,068.6**	920.6	651.4
Neither individually impaired nor on watchlist	**2,695.7**	**2,444.3**	3,354.0	3,025.1
	4,680.7	**3,899.2**	4,851.6	4,034.2

Of the above, £48m is not held as first charge.

Impairment
Corporate customers are placed on a watchlist when they show signs of unsatisfactory performance and require close control, but are currently expected to continue trading and where no provision for bad debt is required.

The Group also reviews monthly all higher risk loans and considers the potential loss which might arise were the borrowers to fail (notwithstanding that continued trading remains the expectation). Events which may trigger higher risk status include a deteriorating balance sheet, material losses, trading difficulties (eg loss of material contracts or suppliers), breach of financial covenants, poor account conduct, arrears and material reduction in value of security. A collective impairment provision is raised against these loans based on the total estimated loss that may arise and the propensity for the borrower to fail. In such circumstances, the Group works with the customers to resolve their business problems and agree a clear strategy, often with the support of external, independent professional advisors.

Individual impairment provisions are raised at the point when business performance is assessed to have deteriorated to the extent that there is a real risk of loss of principal, interest or fees. Provisions will be required on some or all of the entire shortfall between the security held and the loan balance outstanding and represent a realistic assessment of the likely net loss after realisation of any security.

Objective evidence of impairment may include:

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

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

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

The table below shows:

- impaired customer balances as a percentage of gross customer balances; and
- credit protection, ie impairment provisions and fair value adjustments as a percentage of impaired customer balances.

1. Credit risk continued

	2011	2010
Gross loans and advances to customers	**8,991.5**	8,720.4
Fair value adjustments	**251.5**	265.4
Other accounting adjustments	**(99.9)**	(178.2)
Gross customer balances	**9,143.1**	8,807.6
Impaired customer balances	**960.5**	659.0
Impaired as a % of gross customer balances	**10.5%**	7.5%
Credit protection		
Impairment provisions	**117.3**	55.8
Fair value adjustments	**251.5**	265.4
	368.8	321.2
Credit protection as a % of impaired customer balances	**38.4%**	48.7%

Forbearance

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

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

For those customers that benefit from ongoing concessions (such as postponement of principal payments), the Group retains the forbearance status for as long as the concession remains in place and does not remove them from the watchlist until at least six months later. In the event of one off concessions (such as capitalisation of interest payments), the Group removes the forbearance status 12 months after their occurrence, and retains the customers on the watchlist for at least the same period of time.

Customers who stop exhibiting higher risk traits are removed from the watchlist. This is dependent upon the Group's satisfaction that the triggers leading to inclusion on the watchlist no longer apply, such as:

- balance sheet improvements (eg cash injection, agreement with creditors or funders on revised terms);
- return to an acceptable level of profitability and cash flow;
- improved account conduct;
- the loan to security value is restored, or additional security taken; or
- covenant breach cured or revised covenants agreed.

Removal from the watchlist usually requires the customer's management information to show that trading is achieving the revised plan with a reasonable expectation for this to continue. The internal guideline is for at least six months' satisfactory trading to have been evidenced.

In addition to the above, other forbearance concessions the Group may grant are considered to be objective evidence of impairment and include:

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

1.4.2 Investment securities

Policies are in place within Treasury with regard to the management and valuation of collateral, with daily monitoring undertaken. Repos and secured lending positions are revalued daily with margin calls on collateralised swaps predominantly made daily, save for several arrangements which permit calls on a weekly basis. Eligible financial collateral for Basel II reporting purposes includes gilts held under reverse repo agreements and cash held under both repo agreements and collaterised swap arrangements. The guarantees relied upon are either parental guarantees held against subsidiary exposures within bank groups or sovereign guarantees.

At the balance sheet date, the Group has a total investment securities portfolio of £4,616.2m (2010: £4,988.4m) of which £46.4m (2010: £97.3m) is considered impaired and against which £45.2m (2010: £85.3m) of provisions are held.

1.4.2.1 Impaired assets

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

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

1.4.2.2 Past due but not impaired

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

Risk management continued
For the year ended 31 December 2011
All the amounts are stated in £m unless otherwise indicated

1. Credit risk continued
1.4.2.3 Neither past due nor impaired
The Group only invests in high quality treasury assets. Within the investment securities portfolio 89% (2010: 82%) of exposures have an external credit rating equivalent to Fitch A or above.

1.4.3 Loans and advances to banks
None of the Group's exposures to loans and advances to banks are impaired. The Group considers that its exposures to loans and advances to banks are all of low to medium risk.

1.5 Eurozone risk
The Group remains a low risk UK based operation. It has no sovereign exposure to 'peripheral' eurozone countries (Portugal, Ireland, Italy, Greece and Spain). As at 31 December 2011 the Group had a £90m (2010: £nil) exposure to the Government of Finland, repayable in over one year. It held no other European sovereign debt.

The Group has no direct exposure to Greek financial institutions or any other counterparties. Other peripheral eurozone country limits and counterparty limits have continued to be managed downwards. Higher risk eurozone exposures to financial institutions, namely those to the other peripheral eurozone countries and Belgium, continue to be closely monitored. Management action has been proactively taken and, where necessary, additional actions are taken in light of any downgradings.

1.5.1 Direct exposures
The analyses on the following pages set out the Group's exposures to financial institutions in European countries, both by asset maturity and by asset type.

The Group has exposures to financial institutions in the following European countries at 31 December 2011:

Country	**Repayable within 30 days**	**Repayable within 1 year but more than 30 days**	**Repayable in over 1 year**	**Credit risk mitigation**	**Total exposure**
2011					
Austria	**–**	**44.2**	**–**	**(4.1)**	**40.1**
Belgium	**–**	**20.0**	**34.0**	**(34.0)**	**20.0**
Denmark	**7.8**	**–**	**–**	**–**	**7.8**
Finland	**–**	**–**	**–**	**–**	**–**
France	**174.7**	**5.3**	**135.3**	**–**	**315.3**
Germany	**39.2**	**104.5**	**38.4**	**(15.7)**	**166.4**
Ireland	**5.0**	**25.0**	**–**	**–**	**30.0**
Italy	**–**	**–**	**–**	**–**	**–**
Netherlands	**0.1**	**40.2**	**210.6**	**–**	**250.9**
Portugal	**–**	**33.5**	**–**	**–**	**33.5**
Spain	**59.0**	**84.2**	**33.6**	**(31.5)**	**145.3**
Sweden	**10.2**	**10.0**	**7.3**	**–**	**27.5**
Switzerland	**73.1**	**10.0**	**413.8**	**(263.6)**	**233.3**
	369.1	**376.9**	**873.0**	**(348.9)**	**1,270.1**

Country	Repayable within 30 days	Repayable within 1 year but more than 30 days	Repayable in over 1 year	Credit risk mitigation	Total exposure
2010					
Austria	–	–	40.1	–	40.1
Belgium	98.1	43.0	45.8	–	186.9
Denmark	–	5.2	0.4	–	5.6
Finland	–	25.0	–	–	25.0
France	365.8	491.7	227.8	(273.5)	811.8
Germany	238.5	–	157.9	–	396.4
Ireland	–	98.8	32.9	–	131.7
Italy	260.8	150.8	–	–	411.6
Netherlands	10.1	–	–	–	10.1
Portugal	–	–	34.4	–	34.4
Spain	226.7	91.2	198.7	(32.7)	483.9
Sweden	–	–	–	–	–
Switzerland	0.5	17.0	140.3	(73.6)	84.2
	1,200.5	922.7	878.3	(379.8)	2,621.7

For the purposes of the above table, exposures to counterparties which comprise subsidiaries of larger banking groups have been aggregated at the group level with the associated risk country being that of the ultimate parent entity.

1. Credit risk continued

Credit risk mitigation takes the form of UK gilt collateral held in relation to reverse repo transactions, cash collateral held in relation to sold repo and derivative transactions, and Government guarantees (including £34.0m by the Belgian government) in relation to specific debt security holdings.

As at 31 December 2011, exposure to European multilateral development banks (not included in the above table given the supranational status associated with these institutions) stood at £529.0m (2010: £48.1m) before credit risk mitigation (£457.5m post-credit risk mitigation (2010: £48.1m)) of which £81.8m matures within a year.

Ongoing exposure to 'peripheral' eurozone counterparties is primarily restricted to short dated money market lending. Where investment assets are held for peripheral eurozone counterparties these are deemed to be in run-off, with associated counterparty and country limits reducing upon maturity or sale.

The table below shows the Group's exposure to financial institutions in European countries by asset type.

Country	**Bank and money market balances**	**Bonds**	**Derivatives**	**Other**	**Total exposure**
2011					
Austria	**–**	**40.1**	**–**	**–**	**40.1**
Belgium	**–**	**20.0**	**–**	**–**	**20.0**
Denmark	**1.0**	**–**	**–**	**6.8**	**7.8**
Finland	**–**	**–**	**–**	**–**	**–**
France	**–**	**63.2**	**24.4**	**227.7**	**315.3**
Germany	**0.2**	**103.3**	**23.9**	**39.0**	**166.4**
Ireland	**–**	**30.0**	**–**	**–**	**30.0**
Italy	**–**	**–**	**–**	**–**	**–**
Netherlands	**0.1**	**250.8**	**–**	**–**	**250.9**
Portugal	**–**	**33.5**	**–**	**–**	**33.5**
Spain	**–**	**126.3**	**19.0**	**–**	**145.3**
Sweden	**20.2**	**7.3**	**–**	**–**	**27.5**
Switzerland	**20.7**	**–**	**53.3**	**159.3**	**233.3**
	42.2	**674.5**	**120.6**	**432.8**	**1,270.1**

Country	Bank and money market balances	Bonds	Derivatives	Other	Total exposure
2010					
Austria	–	40.1	–	–	40.1
Belgium	124.3	62.6	–	–	186.9
Denmark	–	5.1	0.4	0.1	5.6
Finland	–	25.0	–	–	25.0
France	526.1	228.8	36.5	20.4	811.8
Germany	262.6	103.1	30.5	0.2	396.4
Ireland	10.5	118.4	2.8	–	131.7
Italy	290.8	120.8	–	–	411.6
Netherlands	10.0	–	–	0.1	10.1
Portugal	–	34.4	–	–	34.4
Spain	256.7	190.1	37.1	–	483.9
Sweden	–	–	–	–	–
Switzerland	–	17.0	66.7	0.5	84.2
	1,481.0	945.4	174.0	21.3	2,621.7

In addition to the above exposures to financial institutions, in the overseas European Economic Area (EEA as defined by the European Banking Authority) and Switzerland, corporate customer exposures at 31 December 2011 totalled £184.4m (2010: £194.6m). There are no exposures to retail customers based outside of the UK and Channel Islands.

The Group continues to monitor developments daily across all countries as they affect the Treasury portfolio. A number of pro-active management actions have been taken to reduce the risk, stress the portfolio and anticipate future downward rating actions. These include significant tenor reductions to improve flexibility, active limit management and revised strategy to take on more secured trading and lower risk business. Regular stress testing of the entire credit limits portfolio is undertaken.

Risk management continued
For the year ended 31 December 2011
All the amounts are stated in £m unless otherwise indicated

1. Credit risk continued
Treasury operates a risk based approach which monitors counterparty limits and exposure via a credit risk register. The counterparties or the assets held are monitored against a Board approved matrix of risk tolerance and associated RAG (Red, Amber, Green) indicators. The credit risk register is updated for rating actions, market events and financial results as they are announced which may influence a change in risk status and possible escalation requiring management actions and inclusion on the watchlist.

The Treasury risk team reviews the entire portfolio and watchlists monthly for appropriate risk status bandings. The Exposures Committee reviews the watchlist on a monthly basis and provide its observations and required management actions as appropriate.

Red watchlist exposures totalled £277m as at 31 December 2011, this comprised holdings in FRNs issued by German (£75m), Irish (£30m) and Portuguese (£34m) financial institutions. Of these, FRNs totalling £202m reached maturity and were repaid in full during January and February 2012, the remaining £75m Red watchlist exposures being to German (£25m) and Spanish (£50m) financial institutions with the latest maturity dates 1 June 2012 (Spain) and 24 August 2012 (Germany).

1.5.2 Indirect exposures
Treasury risk management monitoring extends beyond the direct risk incurred through counterparty trading, to the underlying exposures (eg to peripheral eurozone countries) which Treasury's counterparties may maintain on their own balance sheets. In analysing each counterparty's secondary exposure we assess the vulnerability and impact on that firm if it suffered different degrees of losses. We also perform stress testing to assess the impact of potential further downgrades on the credit risk of our exposure.

Where secondary sovereign exposure is deemed to undermine the performance of the counterparty, remedial management actions are taken in respect of Treasury's counterparty limits and exposure, often well ahead of any associated rating actions.

2. Liquidity risk
2.1 Capital and liquidity framework
The Group's capital and liquidity management framework comprises:

- an asset and liability management control programme;
- risk, capital and liquidity quantification and mitigation techniques and processes;
- management actions linked through to stress testing and capital and liquidity planning models, enabling a method of mitigating the effects of a severe but plausible economic stress;
- defined processes to invoke necessary management actions detailed in the Internal Capital Adequacy Assessment Process (ICAAP) submission document;
- articulation of how liquidity risk is identified, measured, monitored and managed in the Individual Liquidity Adequacy Assessment (ILAA) and procedures and governance in place to mitigate the risk;
- a defined risk appetite, controls and governance in the Group's capital and liquidity management policies; and
- detailed and documented ongoing development and embedding plans for capital adequacy, capital allocation and risk appetite development.

Impacts on capital and liquidity of a severe economic downturn are stress tested to ensure sufficient and proactive management actions, triggers, systems and controls are in place.

The risk appetite reflects the amount and type of risk that the Group is prepared to seek, accept or tolerate as defined in the following four capital objectives:

- maintain capital quantity and quality adequate to cover existing and projected risks in the business;
- maintain capital adequate to be confident of weathering extreme but plausible market scenarios;
- maintain operations such that we are confident that our customer service and our reputation are sustained in extreme but plausible scenarios; and
- generate good, stable returns for members.

The Group is progressing towards implementation of Basel III and other UK and EU risk and capital legislative requirements. These include the Capital Requirements Directive IV and considerations resulting from the reports issued by the Independent Commission on Banking.

2.2 Liquidity risk
2.2.1 Overview
Liquidity risk arising from the structure of the balance sheet (structural liquidity) is managed in line with policies developed by ALCO. The Group's liquidity management policies are reviewed and approved annually by the RC (on behalf of the Board) and compliance reviewed monthly by ALCO. The Group's policy is to ensure that sufficient funds are available at all times to meet demands from depositors, to fund agreed advances, to meet other commitments as and when they fall due, and to ensure the Board's risk appetite is met.

The Group operates within a liquidity risk framework of stress testing combined with a number of strategic and tactical measures which feed into an overall liquidity status score. This is supported with detailed contingency funding plans which are tested and reviewed on a regular basis. The Group's liquidity management framework is designed in line with FSA BIPRU regulations and industry guidelines, including Institute of International Finance and Bank for International Settlements recommendations.

The Board's risk appetite for liquidity risk is defined as survival in a number of stress scenarios, adherence to specific ratios and compliance with all regulatory limits. The stress tests encompass survival across various timescales and a range of adverse liquidity events, both firm specific and market wide, which cover all aspects of the liquidity risk to which the Group is exposed.

The Group monitors its liquidity position on a daily basis against the Board approved liquidity risk appetite and stress scenario. It also monitors the adequacy of its controls to provide assurance that liquidity risk is being appropriately managed, and regularly assesses its funding position.

2. Liquidity continued

The Group manages liquidity risk by applying:

- a systematic control process embedded in the Group's operations; and
- controlled end to end liquidity management with:
  – net outflows monitored to ensure they are within FSA limits;
  – maintenance of a diversified funding base;
  – management of liquid assets: high quality primary liquidity including cash and gilts, along with secondary liquidity including certificates of deposit;
  – target strategic ratios; and
  – stress testing.

The strategic measures approved by the Board and monitored monthly are:

- wholesale borrowing ratio, 17.8% (2010: 17.2%) – the amount of wholesale borrowing compared to total liabilities;
- liquid asset ratio, 15.5% (2010: 9.8%) – amount of total assets that are unencumbered high quality liquid assets as defined under BIPRU; and
- customer loan/deposit ratio, 93.9% (2010: 102.5%) – the ratio of customer loans to customer deposits.

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

The Group has a high proportion of retail assets funded by retail deposits demonstrated by the loan/deposit ratio which averaged 99.3% during 2011, ensuring there is no over reliance on wholesale funding. There are customer funding and wholesale funding target ratios as described above which are set in line with the Board approved strategic plan. 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 ten years. The behaviour of retail products is reviewed by ALCO and, in addition, the Group has maturity mismatch limits to control the exposure to longer term mismatches.

The Group continually reviews its structural funding position and is confident that current funding plans will ensure that it will meet the requirements of the net stable funding ratio proposed by Basel III.

Marketable assets are maintained as a liquidity pool against potential retail outflows. The liquidity pool is the highest quality debt and consists of government issued debt and cash at the Bank of England. Liquid assets increased at the end of 2011 as demonstrated by a liquid asset ratio of 15.5%, having averaged 12.1% during 2011 as a whole.

The table below shows the market value and composition of the liquid asset buffer:

	2011	2010
Qualifying stock		
Operational balances with central banks (note 13)	**6,378.3**	1,443.7
Treasury bills	**–**	1,997.6
Gilts	**1,085.5**	903.3
Multilateral development banks	**162.1**	50.9
	7,625.9	4,395.5

The Group has access to a variety of medium term wholesale funding sources: securitisation, regulated covered bond and Euro Medium Term Notes. The Group will issue from the programmes as funding requirements and market conditions permit.

ALCO discusses the actual liquidity position and projected position incorporating business plans. More frequent meetings are held if necessary, when the markets have a heightened period of stress or liquidity shortage. The meetings ensure that the business plans are accurate and can be flexed as required.

The Group's primary objective in respect of secured funding is to raise longer term funds (over one year in duration) and to diversify the source of funds from wholesale means to support the business plan of the Group. The Group ensures that sufficient eligible and unencumbered assets are available at all times to meet the needs of its secured funding programmes. For further details of encumbered assets see note 15 and note 35 regarding assets pledged.

2.2.2 Liquidity gap

The Group's liquidity position is monitored on a daily basis and reported to ALCO. Treasury holds a pool of liquid assets on behalf of the Group, and management actions are in place to provide additional liquidity when required. These sources of liquidity are held in order to be available to meet unexpected liquidity requirements.

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

- retail and corporate deposit bases are very stable, with deposits being attracted to the Group by good customer service and its ethical policy. As a result, the deposit base remains stable although the contractual maturity is immediate for instant access deposits; and
- personal loan and visa balances are repaid earlier than their contractual maturity date.

2.2.3 Gross cashflow maturity analysis

Gross cash flows include interest and other revenue cash flows. The following table is an analysis of:

- gross undiscounted contractual cash flows of financial liabilities held at the balance sheet date; and
- behavioural adjustments that reflect the actual behaviour of customers based on historic cashflow profiles over a period of ten years.

Risk management continued
For the year ended 31 December 2011
All the amounts are stated in £m unless otherwise indicated

2. Liquidity continued

2011 Group Contractual cash flows	**Carrying value**	**Gross nominal outflow**	**Less than 1 month**	**1–3 months**	**3–12 months**	**1–5 years**	**Over 5 years**
Non-derivative liabilities							
Deposits by banks	**3,302.7**	**3,397.1**	**1,591.2**	**583.9**	**323.1**	**898.9**	**–**
Customer accounts	**34,990.6**	**35,109.5**	**23,457.6**	**2,540.4**	**7,126.5**	**1,985.0**	**–**
Customer accounts – capital bonds	**1,429.8**	**1,420.3**	**–**	**97.9**	**425.3**	**892.4**	**4.7**
Debt securities in issue	**4,164.8**	**5,187.2**	**147.8**	**138.7**	**186.9**	**3,264.7**	**1,449.1**
Other borrowed funds	**1,258.8**	**2,305.8**	**7.2**	**4.6**	**77.1**	**878.6**	**1,338.3**
Amounts owed to other Co-operative Group undertakings	**132.3**	**132.3**	**132.3**	**–**	**–**	**–**	**–**
	45,279.0	**47,552.2**	**25,336.1**	**3,365.5**	**8,138.9**	**7,919.6**	**2,792.1**
Derivative liabilities							
Net outflow	**1,087.9**	**2,137.0**	**284.5**	**31.3**	**204.9**	**559.7**	**1,056.6**
	46,366.9	**49,689.2**	**25,620.6**	**3,396.8**	**8,343.8**	**8,479.3**	**3,848.7**
Other liabilities	**315.6**	**–**	**–**	**–**	**–**	**–**	**–**
Total recognised liabilities	**46,682.5**	**49,689.2**	**25,620.6**	**3,396.8**	**8,343.8**	**8,479.3**	**3,848.7**
Unrecognised loan commitments	**4,752.7**	**4,752.7**	**4,571.3**	**160.6**	**20.8**	**–**	**–**
Total liabilities	**51,435.2**	**54,441.9**	**30,191.9**	**3,557.4**	**8,364.6**	**8,479.3**	**3,848.7**
Behavioural adjustments							
Customer accounts	**–**	**–**	**(20,526.5)**	**464.1**	**1,230.3**	**18,832.1**	**–**
Debt securities in issue	**–**	**–**	**–**	**–**	**–**	**–**	**–**
Total liabilities – behavioural	**51,435.2**	**54,441.9**	**9,665.4**	**4,021.5**	**9,594.9**	**27,311.4**	**3,848.7**

2010 Group Contractual cash flows	Carrying value	Gross nominal outflow	Less than 1 month	1–3 months	3–12 months	1–5 years	Over 5 years
Non-derivative liabilities							
Deposits by banks	2,938.6	2,931.0	776.3	415.8	774.4	964.5	–
Customer accounts	32,320.0	32,588.8	20,347.0	1,856.8	6,811.5	3,573.5	–
Customer accounts – capital bonds	1,794.7	1,749.4	11.4	64.1	254.8	1,362.6	56.5
Debt securities in issue	4,212.2	5,006.4	303.9	695.6	397.4	1,172.4	2,437.1
Other borrowed funds	975.4	1,799.6	45.8	4.7	58.0	420.8	1,270.3
Amounts owed to other Co-operative Group undertakings	188.5	188.5	188.5	–	–	–	–
	42,429.4	44,263.7	21,672.9	3,037.0	8,296.1	7,493.8	3,763.9
Derivative liabilities							
Net outflow	702.4	794.2	139.5	37.5	121.6	295.5	200.1
	43,131.8	45,057.9	21,812.4	3,074.5	8,417.7	7,789.3	3,964.0
Other liabilities	376.4	–	–	–	–	–	–
Total recognised liabilities	43,508.2	45,057.9	21,812.4	3,074.5	8,417.7	7,789.3	3,964.0
Unrecognised loan commitments	4,759.5	4,759.5	4,499.3	62.5	188.2	9.5	–
Total liabilities	48,267.7	49,817.4	26,311.7	3,137.0	8,605.9	7,798.8	3,964.0
Behavioural adjustments							
Customer accounts	–	–	(18,159.2)	234.3	(2,597.7)	20,522.6	–
Debt securities in issue	–	(25.7)	–	(25.7)	–	–	–
Total liabilities – behavioural	48,267.7	49,791.7	8,152.5	3,345.6	6,008.2	28,321.4	3,964.0

The Bank's gross cashflow maturity analysis has not been disclosed as it is not materially different from the above Group disclosure.

3. Market risk

The Group's market risk includes interest rate risk, interest basis risk and currency risk. The majority of the Group's market risk arises from changes in interest rates.

3.1 Interest rate risk

Interest rate risk policy statements, approved by the RC on behalf of the Board, specify the scope of the Group's wholesale market activity, market risk limits and delegated authorities. The policy is managed by ALCO. Its prime task is to assess the interest rate risk inherent in the maturity and repricing characteristics of the Group's assets and liabilities. The Group seeks to minimise the volatility of future earnings from interest rate changes and all interest rate risk exposure is removed from the retail and CABB divisions and consolidated at the centre where it is managed from the core balance sheet within agreed limits. Treasury is responsible for interest rate risk management for the Group. The principal analytical techniques involve assessing the impact of different interest rate scenarios and changes in balances over various time periods.

The Board receives reports on the management of balance sheet risk and ALCO reviews the balance sheet risk position and the utilisation of wholesale market risk limits.

3.1.1 Non-treasury interest rate risk

The Group (excluding wholesale) uses a gap report and earnings approach for 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.

ALCO monitors the non-trading interest rate risk which is split between certain wholesale portfolios, banking and investment books, and the rest of the Group's balance sheet. The following describes the Group non-trading portfolios excluding these certain wholesale portfolios. These positions are managed by Treasury. All interest rate risk is centralised into Treasury using appropriate transfer pricing rates.

Gap reports are based on defined time periods. ALCO sets guidance limits around the gap, principally that the sum of positions maturing in greater than 12 months and non-sensitive balances (including non-maturity deposits) is no more than a set limit.

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. Drawdown risk, in particular for fixed rate mortgages, is managed through weekly balance sheet meetings. The balance sheet management team undertakes hedges for interest rate risk using derivative instruments and investment securities which are executed via the Treasury markets team to external wholesale markets, and loans and deposits which are executed internally with the Treasury markets team.

Basis risk is the risk that different assets and liabilities reprice with reference to different indices and at different times. This exposes the Group to income volatility if indices do not move in a ratio of one to one. This risk is managed by performing a future simulation of the balance sheet to establish what the Group's income volatility would be if the rates do not move in a one for one ratio. Cash placements are then undertaken with the Treasury markets team to reduce the income volatility. The Treasury markets team executes external trades as required.

The table below illustrates the sensitivity analysis relating to the Group, a primary measure in the approach to managing interest rate risk.

The table illustrates the greater than 12 month net gap position at the end of the year on the Group's balances excluding wholesale treasury and customer currency balances, which are managed within the treasury risk framework. The gap is driven by product pricing and product mix. The gap is calculated by placing all assets and liabilities at the earliest of their repricing or maturity date and then summing by time band. The aim is to have assets evenly spread so that the Group is not exposed to sudden rate movement. The net position shows the amount that the Group is either over or under invested in the month. A £100m gap position would equate to the Group being exposed to income variation of £1m per annum if rates moved by 1%, so the maximum position equates to approximately £8m income exposure if rates moved by 1%.

	Net greater than 12 month position	
	2011	2010
At the year end	**(279)**	(204)
Average for the period	**(330)**	(69)
Maximum sensitivity for the period	**806**	(876)
Minimum sensitivity for the period	**(51)**	56

3.1.2 Treasury interest rate risk

Treasury executes short term funding and hedging transactions with the wholesale markets on behalf of the Group 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.

3.1.2.1 Value at risk (VaR)

VaR measures the daily maximum potential gain or loss due to market volatility within a statistical confidence level of 95% and a one day holding period. The VaR methodology used is historical simulation using a time series of one year to latest day and was £0.35m at 31 December 2011 for the Treasury traded portfolios. 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 as the sole measure of risk.

3.1.2.2 PV100

This 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. The effects of a 1% increase in interest rates are £15.1m (2010: (£11.0m)) and a 1% decrease (£16.0m) (2010: £9.1m).

Risk management continued
For the year ended 31 December 2011
All the amounts are stated in £m unless otherwise indicated

3. Market risk continued
3.2 Currency risk
The Group's treasury foreign exchange activities primarily:

- provide a service in meeting the foreign exchange requirements of customers;
- maintain liquidity in euros and US dollars by raising funds and investing these to generate a return; and
- perform limited intraday trading and overnight positioning in major currencies to generate incremental income.

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

	31 December 2011					31 December 2010				
Group	**£**	**$**	**€**	**Other**	**Total**	£	$	€	Other	Total
Assets										
Cash and balances at central banks	**6,696.6**	**–**	**–**	**–**	**6,696.6**	1,735.6	–	–	–	1,735.6
Loans and advances to banks	**1,568.1**	**59.5**	**373.4**	**5.5**	**2,006.5**	1,879.9	35.4	475.3	3.5	2,394.1
Loans and advances to customers	**33,513.4**	**54.7**	**157.3**	**40.6**	**33,766.0**	34,797.5	50.3	114.4	15.1	34,977.3
Fair value adjustments for hedged risk	**366.3**	**–**	**–**	**–**	**366.3**	166.8	–	–	–	166.8
Investment securities – loans and receivables	**656.8**	**16.2**	**131.9**	**–**	**804.9**	1,500.0	68.1	294.0	55.2	1,917.3
Investment securities – available for sale	**3,127.8**	**124.7**	**170.5**	**–**	**3,423.0**	1,871.7	379.8	444.9	260.7	2,957.1
Investment securities – at fair value through income or expense	**335.8**	**–**	**7.3**	**–**	**343.1**	28.7	–	–	–	28.7
Derivative financial instruments	**975.3**	**0.2**	**0.3**	**–**	**975.8**	975.2	0.1	0.3	–	975.6
Equity shares	**5.7**	**–**	**–**	**–**	**5.7**	7.2	–	–	–	7.2
Investments in Group undertakings	**2.7**	**–**	**–**	**–**	**2.7**	2.5	–	–	–	2.5
Goodwill	**0.6**	**–**	**–**	**–**	**0.6**	0.6	–	–	–	0.6
Intangible fixed assets	**40.7**	**–**	**–**	**–**	**40.7**	45.1	–	–	–	45.1
Investment properties	**172.7**	**–**	**–**	**–**	**172.7**	162.3	–	–	–	162.3
Property, plant and equipment	**80.1**	**–**	**–**	**–**	**80.1**	98.5	–	–	–	98.5
Amounts owed by other Co-operative Group undertakings	**179.2**	**–**	**–**	**–**	**179.2**	0.6	–	–	–	0.6
Other assets	**44.9**	**0.2**	**1.5**	**–**	**46.6**	3.5	0.7	2.9	1.7	8.8
Prepayments and accrued income	**18.7**	**–**	**–**	**–**	**18.7**	16.2	–	–	–	16.2
Deferred tax assets	**26.4**	**–**	**–**	**–**	**26.4**	87.0	–	–	–	87.0
Total assets	**47,811.8**	**255.5**	**842.2**	**46.1**	**48,955.6**	43,378.9	534.4	1,331.8	336.2	45,581.3
Liabilities										
Deposits by banks	**2,567.3**	**260.6**	**474.7**	**0.1**	**3,302.7**	1,480.8	473.0	840.4	144.4	2,938.6
Customer accounts	**34,899.1**	**35.5**	**52.3**	**3.7**	**34,990.6**	32,205.8	23.6	88.9	1.7	32,320.0
Customer accounts – capital bonds	**1,429.8**	**–**	**–**	**–**	**1,429.8**	1,794.7	–	–	–	1,794.7
Debt securities in issue	**4,039.4**	**–**	**125.4**	**–**	**4,164.8**	4,007.4	–	204.8	–	4,212.2
Derivative financial instruments	**1,083.7**	**1.3**	**2.9**	**–**	**1,087.9**	689.2	5.2	6.8	1.2	702.4
Other borrowed funds	**1,229.5**	**–**	**29.3**	**–**	**1,258.8**	975.4	–	–	–	975.4
Amounts owed to other Co-operative Group undertakings	**132.3**	**–**	**–**	**–**	**132.3**	188.5	–	–	–	188.5
Other liabilities	**172.9**	**0.3**	**0.5**	**–**	**173.7**	141.3	1.5	2.8	1.2	146.8
Accruals and deferred income	**39.9**	**–**	**–**	**–**	**39.9**	131.3	–	–	–	131.3
Provisions for liabilities and charges	**102.0**	**–**	**–**	**–**	**102.0**	55.8	–	–	–	55.8
Current tax liabilities	**–**	**–**	**–**	**–**	**–**	42.5	–	–	–	42.5
Total liabilities	**45,695.9**	**297.7**	**685.1**	**3.8**	**46,682.5**	41,712.7	503.3	1,143.7	148.5	43,508.2
Net on balance sheet position	**2,115.9**	**(42.2)**	**157.1**	**42.3**	**2,273.1**	1,666.2	31.1	188.1	187.7	2,073.1

The Bank's currency analysis has not been disclosed as it is not materially different from the above Group disclosure.

At 31 December 2011 the Group and Bank's open position was £0.4m (2010: £0.4m) representing a potential loss of £nil given a 3% depreciation in sterling (2010: £nil). The open position is monitored against limits in addition to limits in place on individual currencies. All figures are in £ sterling equivalent.

Unaudited risk management disclosures

The following risk management disclosures, operational risk and additional risks, do not form part of the audited accounts and are not audited.

4. Operational risk

Operational risk includes internal and external fraud, loss or theft of confidential customer information, loss of key personnel, system capacity issues or programme failure and external events over which the Banking Group has limited controls such as terrorist attack.

In order to meet the Banking Group's appetite for operational risk, it ensures appropriate controls are in place to minimise the chance of any significant disruption and to protect our reputation.

Operational risks are identified, managed and mitigated through ongoing risk management practices including risk assessments, formal control procedures and contingency planning. Operational risks and key controls are formally reviewed on a regular basis. Significant operational risks and the associated capital requirements are regularly reported to the ORC, and the RC. These meet regularly to monitor the suitability of the risk management framework and management of significant risks within the Banking Group.

Business continuity is managed by the Operational Risk function and sets out to minimise the risk of disruption in the event of a sudden, unplanned occurrence that could seriously disrupt business operations. This includes developing and exercising crisis and incident management teams to maintain appropriate preparedness in the event of a major operational disruption.

The Banking Group also has a corporate insurance programme to transfer specific risks to insurers as part of its risk management approach.

The Banking Group has a significant change agenda to transform the business. To support this agenda, a transformation risk category has been created to ensure that the management of risks around the design, development and implementation of change is in line with risk appetite.

5. Additional risks

In addition to the significant risks covered above, the following risks are also reported and managed in the Banking Group's risk management framework:

- Co-operative group-wide risks, to include pension, reputation and contagion risk;
- business model and external risk;
- securitisation risk; and
- conduct risk.

5.1 Co-operative group-wide risks

5.1.1 Pension risk

Pension risk is the risk of the Group being unable to meet its pension scheme commitments. Risks are identified at The Co-operative Group level, with the impact of any potential changes to contribution assessed under the Group's risk management framework.

The combined entity is exposed to two distinct areas of pension risk:

- PACE – CFS Management Services Ltd (CFSMS) and the Bank are participating members of The Co-operative Group Pension (Average Career Earnings) – defined benefit scheme; and
- Britannia Pension Scheme – the Group is a participating member of the Britannia Pension Scheme – defined benefit and contribution sections (defined benefit section closed to new members since 2001).

The Co-operative Group, alongside the scheme trustee, is responsible for the risk management arrangements for PACE, agreeing suitable contribution rates, investment strategies and for taking professional advice as appropriate.

CFSMS, alongside the scheme trustee, is responsible for the risk management arrangements for the Britannia Pension Scheme, agreeing suitable contribution rates, investment strategies and for taking professional advice as appropriate.

The Group is therefore exposed to potential future increases in required contributions.

5.1.2 Reputation risk

We define reputation risk as a failure to proactively develop, protect and optimise the value of the brands of The Co-operative Banking Group of companies through inappropriate strategic decisions, poor business performance, operational failure or negative external perception.

As part of the assessment and control of this risk, our business performance and risk profile across all of our risk themes are closely monitored and reviewed. We also proactively monitor and manage media coverage and public and customer opinion, and work closely with external rating agencies to ensure a fair and balanced representation. We believe this approach helps maintain member, customer and market confidence.

5.1.3 Contagion risk

Contagion risks are those risks that could originate from elsewhere in the Group impacting upon entities within the Banking Group.

The Banking Risk Officer for the Group reports directly to the Chief Risk Officer (CRO) for The Co-operative Banking Group, who also acts as the Group Risk Director for the wider Co-operative Group. In addition to attending the Banking Group Risk Committee, the CRO also attends The Co-operative Group Risk and Audit Committee. This allows the CRO to have an independent and holistic view of the risk profile across The Co-operative Group.

5.2 Business model and external risk

Business model and external risk arises from changes to the Banking Group's business and the environment in which it operates, specifically the risk of not being able to carry out the Banking Group's business plan and desired strategy.

The Group's strategy is to grow our business in order to achieve the Banking Group's vision of becoming the compelling, co-operative alternative in the markets in which we compete.

The main challenges to the business plan and strategy are the uncertain economic environment, the changing regulatory environment and the significant internal change programme being managed within the Group and the wider Co-operative Group.

Risk management continued
For the year ended 31 December 2011
All the amounts are stated in £m unless otherwise indicated

5. Additional risks continued
The Board and Executive set and monitor the strategic plan in light of this background having considered the stresses that extreme but plausible scenarios could have upon it.

5.3 Securitisation risk
Securitisation is the process by which a group of assets, usually loans, are aggregated into a pool, and sold to bankruptcy remote special purpose entities (SPEs). The pool of mortgage loans is used to back the issuance of new securities, allowing the credit rating of the securities to be separated from the credit rating of the original company. The Group has established securitisation structures as part of its funding activities, using residential mortgage loans as the underlying asset pool. Securitisations provide a diverse source of funding for the Group.

Asset based securitisation investment is assessed using the ratings based approach, under foundation IRB, where risk weight percentages are applied to each deal depending on the external rating, seniority and granularity of the instrument.

Securitisation risk is the residual credit risk arising from retaining an interest in the Group's securitisation companies through the provision of subordinated debt or start up expense loans and liquidity facilities where applicable. However, the majority of the risk and rewards in respect of the underlying mortgage loan pools are retained by the Group. SPEs are included as subsidiaries in the consolidated financial statements with the Group continuing to recognise securitised assets as loans and advances to customers on the balance sheet, and income from the securitised assets being recognised as income.

The Group has only acted as mortgage originator, servicing agent, and liquidity facility provider in respect of its own securitisations. The Group does not provide bridging loans, nor does it act as underwriter or dealer in its securitisations. All transactions are approved at Board level and benefit from relevant accounting and legal advice to ensure compliance with regulatory/statutory rules.

The Group had previously claimed regulatory capital relief in relation to Leek Finance Number Eighteen plc (Leek 18) and Leek Finance Number Nineteen plc (Leek 19) in accordance with the terms of the Prudential Sourcebook for Banks, Building Societies and Investment Firms (BIPRU9). Following the restructuring of these transactions, initially announced in March 2011, the Group was regarded as providing non-contractual support to Leek 18 and Leek 19. Regulatory capital relief for Leek 18 and Leek 19 was therefore discontinued from June 2011 and in respect of future securitisations for the foreseeable future. No outstanding securitisations afford the Group regulatory capital relief.

5.4 Conduct risk
Conduct risk is the failure to ensure the fair treatment of customers leading to poor outcomes for customers.

The environment could create new risks in different ways. New risks could arise through neglecting post sales service and in not properly considering the intended audience in complex new product design, development and sales processes.

The Banking Group mitigates and prevents emerging conduct risk through the application of appropriate risk management, controls and ongoing oversight and monitoring provided by established Risk and Compliance functions.

Significant conduct risks are regularly monitored and reported up to and challenged by the Risk Committee.

Capital management

For the year ended 31 December 2011

All the amounts are stated in £m unless otherwise indicated

Capital resources

The Group's policy is to maintain a strong capital base so as to maintain investor, creditor and market confidence and to sustain future development of the business. 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.

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

The Group's capital position remains resilient with a year end core tier one position of 9.6% (2010: 9.6%).

Adequate capitalisation can be maintained at all times even under the most severe stress scenarios including the revised FSA 'anchor' stress scenario.

A capital buffer above Individual Capital Guidance (ICG) is being maintained, demonstrating that there is currently more than sufficient surplus capital to cover the Group's PPI risk.

During the year a number of management actions have been implemented to maintain a sufficient level of capital. These include a £87.0m capital contribution from The Co-operative Banking Group, the restructuring of certain securities issued under a securitisation programme (Leeks 17, 18 and 19) and the exchange and issuance of subordinated debt.

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

Tier one capital

Tier one capital includes share capital, retained earnings, and non-cumulative irredeemable preference shares. Retained earnings exclude gains or losses on cashflow 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 six subordinated debt issues and two tranches of perpetual subordinated bonds (PSBs). The rights of payment to the holders of this debt are subordinated to the claims of depositors and other creditors of the Bank. More information on these can be found in note 29.

	2011	2010
Reconciliation of equity per balance sheet to core tier one capital		
Total equity per balance sheet	**2,273.1**	2,073.1
Regulatory adjustments		
Minority interests	**(1.2)**	(1.4)
Retained earnings	**(49.8)**	(18.6)
Available for sale reserve	**(19.5)**	13.1
Cashflow hedging reserve	**(67.6)**	(36.9)
Core tier one capital before regulatory deductions	**2,135.0**	2,029.3

Capital management continued
For the year ended 31 December 2011
All the amounts are stated in £m unless otherwise indicated

Capital resources continued

	2011	2010
Core tier one capital		
Permanent share capital	**410.0**	410.0
Retained earnings	**1,686.0**	1,562.8
Minority interests	**30.2**	31.6
Interim profit	**–**	16.1
Share premium account	**8.8**	8.8
	2,135.0	2,029.3
Other tier one capital		
Non-cumulative irredeemable preference shares	**60.0**	60.0
Total tier one capital before regulatory deductions	**2,195.0**	2,089.3
Intangible assets	**(71.1)**	(69.0)
Expected loss shortfall	**(114.2)**	(50.9)
Securitisation positions	**(2.3)**	(34.4)
Material holdings	**(1.3)**	(1.3)
Total tier one capital after regulatory deductions	**2,006.1**	1,933.7
Tier two capital		
Revaluation reserves	**2.9**	2.9
Collective provisions	**0.7**	–
Subordinated notes and perpetual subordinated bonds	**1,084.0**	884.6
Total tier two capital before regulatory deductions	**1,087.6**	887.5
Expected loss shortfall	**(114.2)**	(50.9)
Securitisation positions	**(2.3)**	(34.4)
Material holdings	**(1.3)**	(1.3)
Total tier two capital after regulatory deductions	**969.8**	800.9
Total capital resources	**2,975.9**	2,734.6

The capital ratios reported in the business and financial review are based on the Pillar 1 capital requirement.

Capital allocation
The allocation of capital among 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 Bank's minimum target return on equity.

Basel III
The Group is working towards compliance with the lastest banking accord, Basel III. It expects to be able to comply fully with the new requirements when they become applicable, including the minimum leverage ratio of 3%.

Critical judgments and estimates

For the year ended 31 December 2011

All the amounts are stated in £m unless otherwise indicated

1. Overview

The Group makes critical judgments and estimates which affect its reported assets, liabilities and profits. Estimates are calculated using various assumptions. Critical judgments and the assumptions used in calculating estimates are continually assessed and reviewed, and are based on historical experience and reasonable expectations of future events. Actual results may differ from these judgments and estimates.

2. Loans and advances

a. Overview

The loan portfolios are reviewed on a continual basis to assess impairment. In determining whether an impairment 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 by the balance sheet date.

The calculation of impairment loss is based on both the likelihood of a loan or advance being written off and the estimated loss on such a write off.

Where loans are subject to forbearance they may be treated as impaired.

b. Collective provisions

i. Retail

Personal advances are identified as impaired by taking account of the age of the debt's delinquency, the product type and the regularity of payments made whilst in arrears. 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 balance for the relevant arrears band.

A key estimate within the provisioning model is the percentage of accounts that will be charged off. A 1% change would change the collective provision by £1.2m.

ii. Corporate

A new corporate collective provision, comprising £10.4m for Group and £4.7m for Bank, has been raised in 2011 reflecting the continuing difficulties and uncertainties currently being experienced in this sector. This provision is based upon a pool of accounts which have been identified as having higher levels of risk. These accounts have been assessed across a risk scale with risk factors of either 30% or 100% attached to each case depending on their position in the scale.

A key estimate within the corporate collective model is collateral valuation. A 10% movement in this estimate would change the provision by £3.0m.

c. Individual provisions

i. Retail

Mortgage accounts are identified as impaired and provided for on an individual basis by taking account of the age of the debt's delinquency on a case by case basis.

A total of £5.3bn of impaired Britannia loans and advances to customers were acquired at a deep discount due to estimated future credit losses. This discount is realised on the actual redemptions of the associated mortgages (mainly in Optimum). A key assumption in the judgment of estimated future credit losses is our estimate of future HPI movements. If future HPI movements were to differ from expectations by 5%, the impact on the estimate would be £7.6m.

A write back of £20.0m of the deep discount has been recognised during 2011 (2010: £15.0m) following a review of the other parameters of the model. Other parameters include forecasts of employment levels, interest rates and the number of accounts in arrears. Because of its steadily improving management of arrears levels, the Group believes there is potential for further write backs. However the level of write back recognised is prudent due to the remaining uncertainties in the exact timing of economic recovery.

ii. Corporate

Each corporate account is assessed and allocated a 'risk grade' to enable the Group to monitor the overall quality of its lending assets. Those of lesser quality, where the lending is potentially at risk and provisions for 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.

A key estimate within the corporate individual model is collateral valuation. A 10% movement in this estimate would change the provision by £7.0m.

For further information on credit risk and impairment see the risk management section on pages 48 to 64.

3. 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. The expected life of an instrument is the period from its inception up to its redemption or maturity date, ie for the mortgage portfolio it would be its redemption date, whilst for the non-mortgage portfolio it would be its maturity date.

On applying this approach to the mortgage portfolio, judgments are made in relation to estimating its average life. These judgments 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. Key judgment areas, regularly reviewed for both current and expected levels of mortgage balance experience, are the average and total lives of the mortgage portfolio.

An increase or decrease in the average life by one year would increase or decrease gross interest income by 0.5% respectively.

During 2011, the Group's Optimum mortgage portfolio was remodelled to reflect current experience of rising average lives, ie higher mortgage balances than predicted. In updating for this trend, the Group expects a higher level of mortgage balances in the medium term but maintains its view that the total portfolio life will end by the year 2023. Extending the average mortgage lives also impacts on redemption rates of the debt securities in issue. The impact of increasing the mortgage redemptions by 10% per annum relating to debt securities in issue fair value adjustments is to decrease profits by a total of £5.7m in the years up to 2013 and to increase profits by the same amount in the following years up to 2017.

Critical judgments and estimates continued
For the year ended 31 December 2011
All the amounts are stated in £m unless otherwise indicated

4. Provisions for liabilities and charges
Provisions are carried in respect of certain known or forecast future expenditure, as described in note 32.

a. Financial Services Compensation Scheme levy
i. Background
The Financial Services Compensation Scheme (FSCS) provides compensation to customers of financial institutions in the event that an institution is unable to pay claims against it. As a result of a number of institutions' failures during 2008, the FSCS borrowed £19.7bn on an interest only basis initially until March 2012 from HM Treasury (HMT) 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 cost. The Group has provided £25.0m for its share of levies that will be raised by the FSCS including the interest on the loan from HMT in respect of the levy years to 31 March 2013. The provision includes estimates for the interest that the FSCS will pay on the loan and of the Group's market participation in the relevant periods.

ii. Current expectations of performance
The FSCS has announced new terms for the calculation of the interest being charged on the loan to the FSCS from HMT for the period commencing 1 April 2012 and thereafter. A rate of 12 month LIBOR plus 100bps will be charged.

For every 50bps that 12 month LIBOR is increased, the Group's year end provision for the FSCS levy would increase by £4.6m.

The FSCS has announced that it expects an additional capital levy totalling £802.0m will be charged in three roughly equal instalments beginning in 2013/14. We have complied with FSA guidance in not providing for such costs at this stage.

b. Payment protection insurance (PPI) provision
i. Background
In October 2010 a Judicial Review proceeding was brought by the British Bankers' Association against the FSA and the Financial Ombudsman Service with regard to the assessment and redress of PPI complaints. On 20 April 2011 the review concluded that cases of PPI complaints should be upheld. The Group subsequently announced it would not participate in any appeal against the UK High Court's judgment (note 32).

ii. Current position and expectations of PPI exposure
The Group has recognised a charge in 2011 of £90.0m (2010: £4.3m) for compensation relating to past sale of PPI policies. This provision represents management's best estimate of the anticipated costs of related customer contact and redress, including administration expenses. At 31 December 2011, after redress and operating costs paid during the year, the remaining provision was £61.7m.

The initial provision was based on the FSA's policy statement and industry claims experience. Its calculation required significant judgment by management in determining appropriate assumptions, which include the level of complaints, uphold rates, proactive contact and response rates and Financial Ombudsman Service referral and uphold rates. The remaining provision is currently management's best estimate of future settlements.

A 1% increase in the expected level of complaints would increase the provision by £0.4m.

5. Contingent consideration
At merger, a commitment was made to all former Britannia members that they would receive in their Co-operative dividend payment an amount equal to or above the amount they would have received in Britannia membership reward had Britannia remained a standalone entity. The Group accrued £47.8m for potential supplementary payments, which was treated as contingent purchase consideration, and paid out £9.4m in respect of 2010. The Group has reviewed the assumptions used to calculate the accrual and concluded that, in reasonably foreseeable circumstances, the expected Co-operative dividends are now more than sufficient to meet this commitment. As a consequence, the Group has released £37.3m of the accrual.

The remaining accrual of £1.1m will be used to pay dividends to former Britannia members under the age of 16 who cannot, legally, become members of The Co-operative Group.

6. Perpetual subordinated bonds
The Group's perpetual subordinated bonds are regularly reviewed for their most relevant effective life. The nature of perpetual bonds indicates an infinite life. However, judgment is required in order to fully amortise their associated fair value adjustments arising on merger.

The 2005 £200.0m issue includes an optional call date in 2015. The Group has made no determination as to whether this call date will be exercised. The Group will make any future call decision on an economic basis and with regards to prevailing market conditions subject to appropriate regulatory approval and in accordance with the terms and conditions of the notes. During 2011, given the Group's unconfirmed call intention, a change of effective life from 2029 to 2015 on the 2005 callable issue has been made. The impact of this change is to reduce profit to 2011 by £21.4m and to increase profit by the same amount in the subsequent periods to 2029. Consequently, as at 2011, the sensitivity of reamortising the 14 years between 2029 and 2015 is on average £1.5m per annum.

For the remaining bonds, the impact of a five year reduction in their effective lives as at 31 December 2011 would reduce profit to 2011 by £5.0m and increase profit by the same amount in the subsequent periods to 2029.

Notes to the financial statements

For the year ended 31 December 2011

All amounts are stated in £m unless otherwise indicated

1. Segmental information

During 2010, the Group reported its operating segments as Retail, Corporate and Markets (CAM) and Other, with CAM being further split into Corporate, Wholesale, Optimum and Platform, and Business Services. This split was in line with the information presented to the Board, the chief operating decision making body of the Group. The Group's internal reporting structure and transfer pricing methodology has been revised in 2011. The Group is now split into Retail, Corporate and Business Banking (CABB) and Other, based on differences in products and services. This level of information is regularly presented to the Board. Revenues are attributed to the segment in which they are generated. Transactions between the reportable segments are on normal commercial terms. Internal charges and transfer pricing adjustments have been reflected in each segment. The comparative information as at 31 December 2010 has been restated as appropriate.

The Bank is comprised of the following main reportable segments:

- **Retail** – customer focused products and services for individuals, sole traders and small businesses. This includes mortgages, credit cards, consumer loans, current accounts and savings products;
- **CABB** – customer focused products and services for businesses and mortgage lending via intermediaries. This includes large corporate and commercial entities. It includes loans, asset finance, current accounts and savings products. It also includes the Optimum closed book of acquired mortgage portfolios and mortgages originated via intermediaries by Britannia prior to its merger with the Bank; and
- **Other** – includes Treasury, other central costs and Unity Trust Bank. Treasury comprises asset and liability management across the balance sheet, including trading activities. Unity Trust is a subsidiary bank operating in the corporate banking and social economy sectors on behalf of trade unions.

	Retail	CABB excluding Optimum	Optimum	**CABB**	Treasury	Other	**Total Other**	**Total**
2011								
Interest margin	**387.4**	96.1	65.4	**161.5**	59.2	10.7	**69.9**	**618.8**
Non-interest income	**150.2**	56.1	12.1	**68.2**	(20.6)	1.0	**(19.6)**	**198.8**
Operating income	**537.6**	152.2	77.5	**229.7**	38.6	11.7	**50.3**	**817.6**
Operating expenses	**(408.7)**	(103.0)	(27.6)	**(130.6)**	(15.3)	(7.0)	**(22.3)**	**(561.6)**
Impairment losses on loans and advances	**(34.3)**	(87.4)	2.8	**(84.6)**	–	(1.6)	**(1.6)**	**(120.5)**
Impairment gains on investments	**–**	–	–	**–**	5.6	–	**5.6**	**5.6**
Operating profit	**94.6**	(38.2)	52.7	**14.5**	28.9	3.1	**32.0**	**141.1**
Significant items								**(53.3)**
Payment protection insurance provision								**(90.0)**
Share of post tax profits from joint ventures								**0.2**
Financial Services Compensation Scheme levies								**(14.5)**
Fair value amortisation								**86.3**
Profit based payments to members of The Co-operative Group								**(15.6)**
Profit before taxation								**54.2**
Income tax								**(4.4)**
Profit for the financial year								**49.8**

The Board relies primarily on net interest revenue to assess the performance of each segment. As a result interest margin is reported on a net basis to the Board. The Group's activities are primarily in the UK.

Notes to the financial statements continued
For the year ended 31 December 2011
All amounts are stated in £m unless otherwise indicated

1. Segmental information continued

Reconciliation to statutory income statement	**2011**
Interest margin	
Total interest margin for reportable segments	**618.8**
Gains on sale of investment securities – loans and receivables	**(37.2)**
Fair value amortisation	**53.4**
Net interest income	**635.0**
Non-interest income	
Total non-interest income for reportable segments	**198.8**
Gains on sale of investment securities – loans and receivables	**37.2**
Fair value amortisation	**–**
Non-interest income	**236.0**
Operating expenses	
Total operating expenses for reportable segments	**(561.6)**
Fair value amortisation	**32.9**
Operating expenses	**(528.7)**
Fair value amortisation	
Total interest unwind for reportable segments	**86.3**
Interest margin unwind	**(53.4)**
Operating expenses unwind	**(32.9)**
Fair value amortisation	**–**

	Retail	CABB excluding Optimum	Optimum	CABB	Treasury	Other	Total Other	Total
2010								
Interest margin	389.1	69.5	76.9	146.4	87.5	9.3	96.8	632.3
Non-interest income	147.2	56.2	10.0	66.2	(25.4)	1.5	(23.9)	189.5
Operating income	536.3	125.7	86.9	212.6	62.1	10.8	72.9	821.8
Operating expenses	(426.1)	(100.8)	(27.1)	(127.9)	(21.2)	(6.3)	(27.5)	(581.5)
Impairment losses on loans and advances	(62.8)	(31.4)	1.4	(30.0)	–	(4.5)	(4.5)	(97.3)
Impairment gains on investments	–	–	–	–	1.5	–	1.5	1.5
Operating profit	47.4	(6.5)	61.2	54.7	42.4	–	42.4	144.5
Significant items								(55.5)
Payment protection insurance provision								(4.3)
Share of post tax profits from joint ventures								0.7
Financial Services Compensation Scheme levies								(11.5)
Fair value amortisation								(14.2)
Profit based payments to members of The Co-operative Group								(10.8)
Profit before taxation								48.9
Income tax								(13.1)
Profit for the financial year								35.8

1. Segmental information continued

Reconciliation to statutory income statement	2010
Interest margin	
Total interest margin for reportable segments	632.3
Reclassification of gains less losses on derivatives	(1.6)
Fair value amortisation	(22.3)
Net interest income	608.4
Non-interest income	
Total non-interest income for reportable segments	189.5
Reclassification of gains less losses on derivatives	1.6
Fair value amortisation	(1.5)
Non-interest income	189.6
Operating expenses	
Total operating expenses for reportable segments	(581.5)
Fair value amortisation	9.6
Operating expenses	(571.9)
Fair value amortisation	
Total interest unwind for reportable segments	(14.2)
Interest margin unwind	22.3
Non-interest income unwind	1.5
Operating expenses unwind	(9.6)
Fair value amortisation	–

	Retail	CABB excluding Optimum	Optimum	Treasury	Total
2011					
Segment assets	**16,217.2**	**9,952.5**	**7,662.4**	**12,342.0**	**46,174.1**
Unallocated assets					**2,186.7**
Total assets for reportable segments					**48,360.8**
Statutory reclassifications					**594.8**
Consolidated total assets					**48,955.6**

	Retail	CABB excluding Optimum	Optimum	Treasury	Total
Segment liabilities	**27,859.2**	**7,657.9**	**–**	**9,004.9**	**44,522.0**
Unallocated liabilities					**1,426.4**
Total liabilities for reportable segments					**45,948.4**
Statutory reclassifications					**734.1**
Consolidated total liabilities					**46,682.5**

Notes to the financial statements continued
For the year ended 31 December 2011
All amounts are stated in £m unless otherwise indicated

1. Segmental information continued

	Retail	CABB excluding Optimum	Optimum	Treasury	Total
2010					
Segment assets	17,314.6	9,095.7	8,111.3	8,556.0	43,077.6
Unallocated assets					1,679.3
Total assets for reportable segments					44,756.9
Statutory reclassifications					824.4
Consolidated total assets					45,581.3

	Retail	CABB excluding Optimum	Optimum	Treasury	Total
Segment liabilities	27,738.7	5,340.4	–	8,647.1	41,726.2
Unallocated liabilities					1,009.2
Total liabilities for reportable segments					42,735.4
Statutory reclassifications					772.8
Consolidated total liabilities					43,508.2

2. Profit before taxation

	2011 £'000	2010 £'000
Profit before taxation is stated after:		
Audit of these financial statements	**356**	457
Amounts receivable by auditors and their associates in respect of:		
Audit of financial statements of subsidiaries pursuant to legislation	**335**	392
Other services pursuant to such legislation	**11**	87
Other services relating to taxation	**311**	7
Services relating to litigation	**2**	2
Services relating to information technology	**147**	92
Services relating to corporate finance transactions	**90**	15
All other services	**365**	822
	1,617	1,874

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

3. Directors' emoluments

	2011 £'000	2010 £'000
Executive directors	**1,645**	4,002
Compensation for loss of office	**926**	–
	2,571	4,002

Directors' activities are undertaken across The Co-operative Banking Group. The figures above reflect the Group's share of these services.

Retirement benefits are accruing to one director (2010: five) under defined benefit schemes.

The aggregate of emoluments and amounts receivable under incentive schemes of the highest paid director was £549k (2010: £1,196k). Accrued pension under defined benefit pension schemes at the year end was £15k (2010: £140k).

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 (2010: £nil). Further details of directors' emoluments are included in the remuneration report on pages 19 to 28. The remuneration report is unaudited.

4. Net interest income

	2011	2010
Interest receivable and similar income		
On financial assets not at fair value through income or expense:		
On loans and advances to customers	**1,482.4**	1,605.0
On loans and advances to banks	**14.3**	9.3
On investment securities	**210.6**	277.5
	1,707.3	1,891.8
On financial assets at fair value through income or expense:		
Net interest expense on financial instruments hedging assets	**(128.1)**	(168.9)
Net interest income/(expense) on financial instruments not in a hedging relationship	**4.5**	(9.6)
	1,583.7	1,713.3

Included within interest receivable is £9.9m (2010: £9.8m) relating to profit on sale of investment securities – available for sale.

Interest income accrued on impaired financial assets during the year was £32.3m (2010: £90.5m). Interest due to unwinding of discount on impairment provisions relating to impaired financial assets amounted to £2.4m (2010: £2.2m).

In the year, the Optimum credit fair value adjustment has been revalued resulting in additional income of £20.0m (2010: £15.0m).

	2011	2010
Interest expense and similar charges		
On financial liabilities not at fair value through income or expense:		
On customer accounts	**524.4**	471.9
On bank and other deposits	**230.9**	515.5
On subordinated liabilities	**98.5**	43.9
On perpetual subordinated bonds	**42.0**	17.2
	895.8	1,048.5
On financial liabilities at fair value through income or expense:		
Net interest expense on financial instruments hedging liabilities	**52.0**	56.4
Net interest expense on financial instruments not in a hedging relationship	**0.9**	–
	948.7	1,104.9

Notes to the financial statements continued

For the year ended 31 December 2011

All amounts are stated in £m unless otherwise indicated

5. Net fee and commission income

	Before significant items 2011	**Significant items 2011**	**After significant items 2011**	Before significant items 2010	Significant items 2010	After significant items 2010
Fee and commission income						
On items not at fair value through income or expense	**238.5**	**(90.0)**	**148.5**	235.9	(13.1)	222.8
On trust or fiduciary activities that result from holding or investing in assets on behalf of others	**1.1**	**–**	**1.1**	1.3	–	1.3
	239.6	**(90.0)**	**149.6**	237.2	(13.1)	224.1
Fee and commission expense						
On items not at fair value through income or expense	**46.0**	**–**	**46.0**	52.2	–	52.2
On items at fair value through income or expense	**8.4**	**–**	**8.4**	8.1	–	8.1
	54.4	**–**	**54.4**	60.3	–	60.3

The significant item in 2011 of £90.0m (2010: £4.3m) is a provision for customer compensation relating to past sales of PPI in response to the FSA's policy statement published on 10 August 2010. The Bank stopped selling non-mortgage PPI at the beginning of 2009. The remaining significant item in 2010 of £8.8m relates to provisions made for customer redress.

6. Net trading income

	2011	2010
Foreign exchange	**3.7**	6.5
Other interest rate instruments	**0.8**	(1.9)
	4.5	4.6

Foreign exchange net trading income includes gains less losses from spot forward and forward contracts, options, futures and translated foreign currency assets and liabilities.

Other interest rate instruments include the result of transacting in government securities, money market instruments, interest rate and currency swaps, options and other derivatives.

7. Other operating income

	2011	2010
Profit on sale of investment securities – loans and receivables	**37.2**	–
Rent receivable from investment properties (note 21)	**7.9**	6.5
Other rent receivable	**1.3**	1.7
Change in fair value of investment properties (note 21)	**(0.1)**	(0.1)
	46.3	8.1

The profit on sale of investment securities arose from the restructuring of a portfolio of assets. Profit on smaller disposals in the normal course of business is included in net interest income.

8. Operating expenses

	Before significant items 2011	**Significant items 2011**	**After significant items 2011**	Before significant items 2010	Significant items 2010	After significant items 2010
Staff costs (note 9)	**294.7**	**34.8**	**329.5**	292.6	29.6	322.2
Administrative expenses	**175.6**	**18.5**	**194.1**	224.9	17.1	242.0
Depreciation of property, plant and equipment (note 22)	**19.6**	**–**	**19.6**	24.8	–	24.8
Amortisation of intangible fixed assets (note 20)	**6.4**	**–**	**6.4**	4.1	–	4.1
Loss on sale of property, plant and equipment	**0.3**	**–**	**0.3**	0.8	–	0.8
Operating lease rentals	**28.4**	**–**	**28.4**	27.7	–	27.7
Property provisions for liabilities and charges provided in the year (note 32)	**0.4**	**–**	**0.4**	3.4	–	3.4
Property provisions for liabilities and charges released during the year (note 32)	**(0.3)**	**–**	**(0.3)**	(0.3)	–	(0.3)
Other provisions for liabilities and charges provided in the year (note 32)	**0.1**	**–**	**0.1**	3.5	–	3.5
Other provisions for liabilities and charges released during the year (note 32)	**(0.1)**	**–**	**(0.1)**	(12.3)	–	(12.3)
Direct expenses from investment properties that generated rental income in the year	**3.5**	**–**	**3.5**	2.6	–	2.6
Direct expenses from investment properties that did not generate rental income in the year	**0.1**	**–**	**0.1**	0.1	–	0.1
	528.7	**53.3**	**582.0**	571.9	46.7	618.6

The significant items in 2011 and 2010 relate to a programme of investment and integration.

No expenditure has been incurred in respect of the Government's Bank Levy since the relevant aggregate liabilities of the Group are below the qualifying threshold.

9. Staff costs

	Before significant items 2011	**Significant items 2011**	**After significant items 2011**	Before significant items 2010	Significant items 2010	After significant items 2010
Wages and salaries	**210.8**	**14.1**	**224.9**	221.0	16.5	237.5
Social security costs	**20.9**	**0.7**	**21.6**	20.6	0.3	20.9
Pension costs:						
Defined benefit plans (note 34)	**0.2**	**–**	**0.2**	0.2	–	0.2
Defined contribution plans (note 34)	**29.0**	**0.8**	**29.8**	28.2	0.5	28.7
Other staff costs	**33.8**	**19.2**	**53.0**	22.6	12.3	34.9
	294.7	**34.8**	**329.5**	292.6	29.6	322.2

The Bank staff costs included above are £262.5m before significant items and £297.4m after significant items (2010: £265.2m before significant items, £294.8m after significant items).

Average number of employees

The average number of persons working for the Group and the Bank during the year is as follows:

	Group		**Bank**	
	No. of employees 2011	No. of employees 2010	**No. of employees 2011**	No. of employees 2010
Full time	**6,260**	6,499	**5,751**	5,843
Part time	**2,104**	2,247	**1,988**	2,117
	8,364	8,746	**7,739**	7,960

Employee activities are undertaken across The Co-operative Banking Group and the figures above reflect the Group and Bank's share of these services.

Notes to the financial statements continued

For the year ended 31 December 2011

All amounts are stated in £m unless otherwise indicated

10. Income tax

	Before significant items 2011	Significant items 2011	After significant items 2011	Before significant items 2010	Significant items 2010	After significant items 2010
Current tax – current year	**(3.4)**	**(38.0)**	**(41.4)**	28.6	(16.7)	11.9
Current tax – prior year	**(6.2)**	**–**	**(6.2)**	0.8	–	0.8
Deferred tax – current year (note 33)	**61.7**	**–**	**61.7**	2.5	–	2.5
Deferred tax – prior year (note 33)	**(9.7)**	**–**	**(9.7)**	(2.1)	–	(2.1)
	42.4	**(38.0)**	**4.4**	29.8	(16.7)	13.1

Further information about deferred income tax is presented in note 33. 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:

	2011	2010
Profit before taxation	**54.2**	48.9
Tax calculated at a rate of 26.49% (2010: 28%)	**14.4**	13.7
Effects of:		
Preference share interest not deductible for tax purposes	**1.5**	1.6
Expenses not deductible for tax purposes	**0.1**	(2.3)
Depreciation of expenditure not qualifying for capital allowances	**1.2**	2.2
Profits taxed at lower rates	**(1.2)**	(3.7)
Non-taxable income	**(0.1)**	(1.2)
Adjustments to tax charge in respect of prior periods	**(15.9)**	(1.3)
Change in rate of deferred tax (note 33)	**4.7**	4.3
Other differences	**(0.3)**	(0.2)
	4.4	13.1

The adjustments to tax charge in respect of prior periods of £15.9m includes £13.0m relating to the taxation of contingent consideration (page 74).

11. Group profit attributable to equity shareholders dealt with in the accounts of The Co-operative Bank plc

	Before significant items 2011	Significant items 2011	After significant items 2011	Before significant items 2010	Significant items 2010	After significant items 2010
Net profit/(loss) attributable to equity shareholders of the Bank	**11.9**	**(105.2)**	**(93.3)**	108.1	(35.0)	73.1

As permitted by Section 408 of the Companies Act 2006, the income statement of The Co-operative Bank plc has not been presented separately.

12. Earnings per share

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

	Before significant items 2011	Significant items 2011	After significant items 2011	Before significant items 2010	Significant items 2010	After significant items 2010
Profit attributable to equity shareholders of the Bank	**153.3**	**(105.3)**	**48.0**	79.5	(43.1)	36.4
Ordinary shares in issue (millions)						
At the beginning of the year	**8,200.0**	**8,200.0**	**8,200.0**	4,600.0	4,600.0	4,600.0
Issued in the year (note 38)	**–**	**–**	**–**	3,600.0	3,600.0	3,600.0
At the end of the year	**8,200.0**	**8,200.0**	**8,200.0**	8,200.0	8,200.0	8,200.0
Weighted average number of ordinary shares in issue (millions)	**8,200.0**	**8,200.0**	**8,200.0**	4,767.7	4,767.7	4,767.7
Basic earnings per share (expressed in pence per share)	**1.87**	**(1.28)**	**0.59**	1.67	(0.90)	0.77

13. Cash and balances at central banks

	Group		Bank	
	2011	2010	**2011**	2010
Cash in hand	**280.3**	255.8	**280.3**	255.8
Balances with the Bank of England other than mandatory reserve deposits	**6,378.3**	1,443.7	**6,378.3**	1,443.7
Included in cash and cash equivalents	**6,658.6**	1,699.5	**6,658.6**	1,699.5
Mandatory reserve deposits with the Bank of England (note 35)	**38.0**	36.1	**38.0**	36.1
	6,696.6	1,735.6	**6,696.6**	1,735.6

Mandatory reserve deposits are not available for use in the Group and Bank's day to day operations, are non-interest bearing and are not included in cash and cash equivalents.

14. Loans and advances to banks

	Group		Bank	
	2011	2010	**2011**	2010
Items in course of collection from other banks	**123.2**	139.9	**123.2**	139.7
Placements with other banks	**896.6**	1,338.8	**885.1**	1,326.8
Included in cash and cash equivalents	**1,019.8**	1,478.7	**1,008.3**	1,466.5
Other loans and advances to banks	**986.7**	915.4	**291.8**	262.1
	2,006.5	2,394.1	**1,300.1**	1,728.6

15. Loans and advances to customers

	Group		Bank	
	2011	2010	**2011**	2010
Gross loans and advances	**34,058.0**	35,199.9	**22,993.1**	24,055.4
Less: allowance for losses on loans and advances to customers	**(292.0)**	(222.6)	**(258.1)**	(210.5)
	33,766.0	34,977.3	**22,735.0**	23,844.9

Group and Bank loans and advances to customers include £114.1m (2010: £74.1m) of financial assets at fair value through income or expense designated at initial recognition to eliminate or significantly reduce a measurement or recognition inconsistency. Of these, £36.7m (2010: £20.0m) are secured by real estate collateral.

Loans and advances to customers include £9,099.8m (2010: £10,611.1m) securitised under the Group's securitisation and covered bond programmes. The Group remains exposed to substantially all of the risks and rewards of ownership of these assets. Included within Group deposits by banks (note 25) are £61.9m (2010: £67.2m) of loans from external third parties and within Group debt securities in issue (note 28) are £3,989.4m (2010: £3,099.8m) of fixed and floating rate notes, all secured on these mortgage assets. Included within the Bank amounts owed by other Co-operative Group undertakings are £4,749.5m (2010: £4,368.4m) of floating rate notes issued to the Bank and £1,000.3m (2010: £2,796.7m) of other loans, secured on these mortgage assets.

Concentration of exposure

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

	Group		Bank	
	2011	2010	**2011**	2010
Property and construction	**4,247.1**	4,544.6	**4,273.2**	2,606.9
Retail distribution and services	**391.6**	500.1	**268.6**	357.0
Business and other services	**4,445.1**	3,808.1	**2,541.2**	3,683.5
Personal – unsecured	**1,518.1**	1,613.1	**1,518.1**	1,613.1
Personal – secured	**23,456.1**	24,734.0	**14,392.0**	15,794.9
	34,058.0	35,199.9	**22,993.1**	24,055.4

Notes to the financial statements continued
For the year ended 31 December 2011
All amounts are stated in £m unless otherwise indicated

15. Loans and advances to customers continued
Allowance for losses on loans and advances

Group	Individual retail	Individual corporate	Collective retail	Collective corporate	Total
2011					
At the beginning of the year	**8.6**	**55.8**	**157.8**	**0.4**	**222.6**
Charge against profits	**4.9**	**76.6**	**36.4**	**12.6**	**130.5**
Amounts written off	**(4.5)**	**(27.1)**	**(26.6)**	**(0.8)**	**(59.0)**
Unwind of discount allowance	**–**	**(0.5)**	**(1.9)**	**–**	**(2.4)**
Interest charged on impaired loans	**–**	**0.3**	**–**	**–**	**0.3**
At the end of the year	**9.0**	**105.1**	**165.7**	**12.2**	**292.0**
2010					
At the beginning of the year	2.3	51.3	139.8	0.6	194.0
Charge against profits	7.2	35.5	63.1	0.8	106.6
Amounts written off	(0.9)	(30.5)	(43.9)	(1.0)	(76.3)
Unwind of discount allowance	–	(1.0)	(1.2)	–	(2.2)
Interest charged on impaired loans	–	0.5	–	–	0.5
At the end of the year	8.6	55.8	157.8	0.4	222.6

Bank	Individual retail	Individual corporate	Collective retail	Collective corporate	Total
2011					
At the beginning of the year	**2.9**	**49.4**	**157.8**	**0.4**	**210.5**
Charge against profits	**0.5**	**62.4**	**34.4**	**6.1**	**103.4**
Amounts written off	**(0.8)**	**(25.6)**	**(26.6)**	**(0.8)**	**(53.8)**
Unwind of discount allowance	**–**	**(0.4)**	**(1.9)**	**–**	**(2.3)**
Interest charged on impaired loans	**–**	**0.3**	**–**	**–**	**0.3**
At the end of the year	**2.6**	**86.1**	**163.7**	**5.7**	**258.1**
2010					
At the beginning of the year	2.3	49.3	139.8	0.6	192.0
Charge against profits	0.9	31.0	63.1	0.8	95.8
Amounts written off	(0.3)	(30.4)	(43.9)	(1.0)	(75.6)
Unwind of discount allowance	–	(1.0)	(1.2)	–	(2.2)
Interest charged on impaired loans	–	0.5	–	–	0.5
At the end of the year	2.9	49.4	157.8	0.4	210.5

A new corporate collective provision for Group of £10.4m and for Bank of £4.7m has been recognised in 2011 reflecting the continuing difficulties and uncertainties currently being experienced in this sector (refer to page 7).

The net impairment charge in the Group income statement is £120.5m (2010: £97.3m). This includes amounts recovered by the Group of £10.0m (2010: £9.3m) against amounts previously written off. The recoveries have been made from the mortgagors and from other parties involved in the origination or acquisition of the mortgages.

15. Loans and advances to customers continued

Loans and advances to customers include finance lease receivables:

	Group		Bank	
	2011	2010	**2011**	2010
Gross investment in finance leases may be analysed as follows:				
No later than one year	**26.1**	28.4	**20.2**	22.4
Later than one year and no later than five years	**62.8**	66.2	**41.9**	44.8
Later than five years	**82.2**	78.7	**65.6**	56.5
	171.1	173.3	**127.7**	123.7
Unearned future finance income on finance leases	**(47.7)**	(44.2)	**(35.4)**	(29.1)
Net investment in finance leases	**123.4**	129.1	**92.3**	94.6
The net investment in finance leases may be analysed as follows:				
No later than one year	**19.1**	21.2	**15.6**	18.0
Later than one year and no later than five years	**40.9**	44.9	**27.5**	32.0
Later than five years	**63.4**	63.0	**49.2**	44.6
	123.4	129.1	**92.3**	94.6

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 £0.1m (2010: £0.8m).

Fair value adjustments for hedged risk

The Group has entered into interest rate swaps that protect it from changes in interest rates on the floating rate liabilities that fund its portfolio of fixed rate mortgages. Changes in the fair values of these swaps are offset by changes in the fair values of the fixed rate mortgages. The changes in fair value of fixed rate mortgages are disclosed on the balance sheet as fair value adjustments for hedged risk immediately below the loans and advances to customers.

Fair value adjustments to loans and advances to customers attributable to portfolio hedged risk in the Group are £366.3m (2010: £166.8m) and in the Bank are £365.8m (2010: £164.6m).

16. Investment securities

Loans and receivables

	Group		Bank	
	2011	2010	**2011**	2010
Loans and receivables				
Listed	**113.5**	164.6	**113.5**	164.6
Unlisted	**694.1**	1,765.7	**755.3**	1,835.2
	807.6	1,930.3	**868.8**	1,999.8
Less: allowance for losses	**(2.7)**	(13.0)	**(2.7)**	(13.0)
	804.9	1,917.3	**866.1**	1,986.8
Included in cash and cash equivalents	**–**	–	**–**	–

The movement in investment securities – loans and receivables excluding interest amounts may be summarised as follows:

	Group		Bank	
	2011	2010	**2011**	2010
At the beginning of the year	**1,914.7**	2,483.5	**1,984.2**	2,552.8
Acquisitions	**107.5**	–	**107.5**	–
Disposals and maturities	**(1,426.6)**	(735.8)	**(1,430.2)**	(748.9)
Exchange adjustments	**1.6**	0.4	**1.6**	0.4
Fair value movements through income or expense	**–**	–	**(0.3)**	11.7
Amortisation	**195.8**	165.1	**191.4**	166.7
Utilisation and release of impairment provision	**10.3**	1.5	**10.3**	1.5
At the end of the year	**803.3**	1,914.7	**864.5**	1,984.2

Notes to the financial statements continued
For the year ended 31 December 2011
All amounts are stated in £m unless otherwise indicated

16. Investment securities continued
Impairment analysis of investment securities – loans and receivables

	Group		Bank	
	2011	2010	**2011**	2010
At the beginning of the year	**13.0**	14.5	**13.0**	14.5
Release for the year	**(5.6)**	(1.5)	**(5.6)**	(1.5)
Utilised during the year	**(4.7)**	–	**(4.7)**	–
At the end of the year	**2.7**	13.0	**2.7**	13.0

Available for sale

	Group		Bank	
	2011	2010	**2011**	2010
Available for sale				
Listed	**3,098.6**	2,389.0	**3,098.6**	2,389.0
Unlisted	**366.9**	640.4	**51.3**	304.7
	3,465.5	3,029.4	**3,149.9**	2,693.7
Less: allowance for losses	**(42.5)**	(72.3)	**(42.5)**	(72.3)
	3,423.0	2,957.1	**3,107.4**	2,621.4
Included in cash and cash equivalents	**210.0**	225.0	**–**	225.0

The movement in investment securities – available for sale excluding interest amounts may be summarised as follows:

	Group		Bank	
	2011	2010	**2011**	2010
At the beginning of the year	**2,948.1**	4,444.1	**2,613.0**	4,049.0
Acquisitions	**8,251.3**	9,868.6	**6,811.3**	8,488.6
Disposals and maturities	**(8,091.4)**	(11,437.4)	**(6,631.3)**	(9,997.4)
Exchange adjustments	**(12.6)**	20.2	**(12.6)**	20.2
Fair value movements through equity	**101.6**	(19.8)	**101.6**	(19.8)
Fair value movements through income or expense	**124.9**	43.9	**124.9**	43.9
Amortisation	**27.1**	28.5	**27.1**	28.5
Utilisation of impairment provision	**29.6**	–	**29.6**	–
At the end of the year	**3,378.6**	2,948.1	**3,063.6**	2,613.0

Impairment analysis of investment securities – available for sale

	Group		Bank	
	2011	2010	**2011**	2010
At the beginning of the year	**72.3**	71.9	**72.3**	71.9
Utilised during the year	**(29.6)**	–	**(29.6)**	–
Exchange adjustments	**(0.2)**	0.4	**(0.2)**	0.4
At the end of the year	**42.5**	72.3	**42.5**	72.3

16. Investment securities continued

Fair value through income or expense

	Group		Bank	
	2011	2010	**2011**	2010
Fair value through income or expense				
Listed	**343.1**	28.7	**343.1**	28.7
	343.1	28.7	**343.1**	28.7
Less: allowance for losses	**–**	–	**–**	–
	343.1	28.7	**343.1**	28.7
Included in cash and cash equivalents	**–**	–	**–**	–

The movement in investment securities – fair value through income or expense excluding interest amounts may be summarised as follows:

	Group		Bank	
	2011	2010	**2011**	2010
At the beginning of the year	**26.5**	–	**26.5**	–
Acquisitions	**323.3**	26.6	**323.3**	26.6
Disposals and maturities	**(25.0)**	–	**(25.0)**	–
Fair value movements through income or expense	**(1.0)**	–	**(1.0)**	–
Amortisation	**15.7**	(0.1)	**15.7**	(0.1)
At the end of the year	**339.5**	26.5	**339.5**	26.5

Analysis of investment securities by issuer

	Group		Bank	
	2011	2010	**2011**	2010
Investment securities issued by public bodies:				
Government securities	**1,834.5**	903.0	**1,834.5**	903.0
Other public sector securities	**563.6**	57.3	**563.6**	57.3
	2,398.1	960.3	**2,398.1**	960.3
Investment securities issued by other issuers:				
Bank and building society certificates of deposits	**315.7**	560.8	**–**	225.1
Other debt securities:				
Credit trading funds	**–**	16.5	**–**	16.5
Other floating rate notes	**1,165.9**	1,624.9	**1,165.9**	1,624.9
Mortgage backed securities	**691.3**	1,740.6	**752.6**	1,810.1
	1,857.2	3,382.0	**1,918.5**	3,451.5
	4,571.0	4,903.1	**4,316.6**	4,636.9

Other floating rate notes (FRNs) relate to sterling, euro and US dollar denominated FRNs with maturities ranging from one month to four years from the balance sheet date.

Notes to the financial statements continued
For the year ended 31 December 2011
All amounts are stated in £m unless otherwise indicated

17. Derivative financial instruments
The Bank, as principal, has entered into various derivatives either as a trading activity, which includes proprietary transactions and customer facilitation, or as a hedging activity for the management of interest rate risk, equity risk and foreign exchange rate risk. Positive and negative fair values have not been netted as the 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 of 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. Equity risk is managed using equity swaps.

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

	Group Fair value		Bank Fair value	
	Assets	**Liabilities**	**Assets**	**Liabilities**
2011				
Derivatives held for trading purposes				
Interest rate derivatives:				
Interest rate swaps	**162.0**	**(141.8)**	**164.7**	**(144.3)**
Over The Counter (OTC) interest rate options	**1.7**	**(1.7)**	**1.7**	**(1.7)**
Total derivative assets/(liabilities) held for trading purposes	**163.7**	**(143.5)**	**166.4**	**(146.0)**
Derivatives held for non-trading purposes				
Derivatives designated as cashflow hedges:				
Interest rate swaps	**218.5**	**(106.2)**	**218.4**	**(106.3)**
Derivatives designated as fair value hedges:				
Interest rate swaps	**137.3**	**(670.5)**	**120.1**	**(666.3)**
Cross currency interest rate swaps	**0.1**	**(60.7)**	**0.1**	**(60.7)**
Derivatives held for non-trading purposes for which hedge accounting has not been applied:				
Interest rate swaps	**13.7**	**(50.6)**	**12.1**	**(51.0)**
Embedded derivatives – options	**28.6**	**(0.4)**	**28.6**	**(0.4)**
Forward currency transactions	**300.9**	**(52.1)**	**46.9**	**(16.9)**
OTC interest rate options	**–**	**(3.5)**	**–**	**(3.5)**
Equity swaps	**113.0**	**(0.4)**	**111.8**	**(0.4)**
Total derivative assets/(liabilities) held for non-trading purposes	**812.1**	**(944.4)**	**538.0**	**(905.5)**
Total recognised derivative assets/(liabilities)	**975.8**	**(1,087.9)**	**704.4**	**(1,051.5)**

17. Derivative financial instruments continued

	Group Fair value		Bank Fair value	
	Assets	Liabilities	Assets	Liabilities
2010				
Derivatives held for trading purposes				
Interest rate derivatives:				
Interest rate swaps	65.1	(51.0)	68.5	(54.4)
Over The Counter (OTC) interest rate options	1.9	(1.9)	1.9	(1.9)
Total derivative assets/(liabilities) held for trading purposes	67.0	(52.9)	70.4	(56.3)
Derivatives held for non-trading purposes				
Derivatives designated as cashflow hedges:				
Interest rate swaps	218.8	(161.9)	218.8	(161.9)
Derivatives designated as fair value hedges:				
Interest rate swaps	75.0	(411.0)	75.0	(403.8)
Cross currency interest rate swaps	–	(1.2)	–	(1.2)
Derivatives held for non-trading purposes for which hedge accounting has not been applied:				
Interest rate swaps	23.1	(32.5)	37.7	(31.3)
Embedded derivatives – options	19.3	(17.8)	19.3	(17.8)
Forward currency transactions	431.4	(23.6)	147.4	(23.6)
OTC interest rate options	–	(1.2)	–	(1.2)
Equity swaps	141.0	(0.3)	136.1	(0.3)
Total derivative assets/(liabilities) held for non-trading purposes	908.6	(649.5)	634.3	(641.1)
Total recognised derivative assets/(liabilities)	975.6	(702.4)	704.7	(697.4)

The derivatives designated as cashflow 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 year there were no forecast transactions for which hedge accounting had previously been used but are no longer expected to occur.

The number of non-margin exchange traded contracts held by the Bank as at 31 December 2011 was nil (2010: nil).

During 2011, in line with industry best practice, the Bank moved from using LIBOR yield curves to using overnight indexed swap (OIS) yield curves in the valuation of cash collateralised derivatives. The net loss in the year relating to this change was £6.0m.

The 2010 comparatives for the Group and Bank reflect a reclassification of £43.7m to derivatives from other assets.

Notes to the financial statements continued
For the year ended 31 December 2011
All amounts are stated in £m unless otherwise indicated

18. Equity shares

	Group and Bank 2011	Group and Bank 2010
Investment securities – unlisted	**5.7**	7.2
Included above are the following trade investments:		
Vocalink Limited – 4,416,165 ordinary shares of £1 each (2010: 4,416,165)	**5.6**	7.1

Equity shares are classified as available for sale.

19. Goodwill

	Group and Bank 2011	Group and Bank 2010
Net book amount		
At the beginning of the year and end of the year	**0.6**	0.6

The Bank's goodwill was recognised in 2009 and relates to the transfer of engagements of Britannia Building Society.

In accordance with IAS 38, the goodwill has been assessed as having an indefinite useful life. The Group tests the asset for impairment by comparing its recoverable amount, determined in accordance with IAS 36, with its carrying amount. The key assumptions used in the calculation are:

- forecast Co-operative Bank operating profits, excluding fair value amortisations, into perpetuity;
- a tax rate of 26% for 2012, falling to and remaining at 25% per annum thereafter; and
- a discount rate of 11% applied to the net operating profit after tax cash flows.

The calculations have been flexed to assess the sensitivities to reasonable changes in the already conservative assumptions. This sensitivity analysis did not indicate any likely impairment of the goodwill.

20. Intangible fixed assets

	Group 2011 Internally generated intangible assets	Group 2011 Other intangible assets	Group 2011 Total	Group 2010 Internally generated intangible assets	Group 2010 Other intangible assets	Group 2010 Total
Cost						
At the beginning of the year	**13.9**	**46.0**	**59.9**	18.9	46.0	64.9
Additions	**2.0**	**–**	**2.0**	3.1	–	3.1
Disposals	**(2.4)**	**–**	**(2.4)**	(8.1)	–	(8.1)
At the end of the year	**13.5**	**46.0**	**59.5**	13.9	46.0	59.9
Accumulated amortisation						
At the beginning of the year	**8.5**	**6.3**	**14.8**	15.1	3.7	18.8
Charge for the year	**1.9**	**4.5**	**6.4**	1.5	2.6	4.1
Disposals	**(2.4)**	**–**	**(2.4)**	(8.1)	–	(8.1)
At the end of the year	**8.0**	**10.8**	**18.8**	8.5	6.3	14.8
Net book value						
At the end of the year	**5.5**	**35.2**	**40.7**	5.4	39.7	45.1
At the beginning of the year	5.4	39.7	45.1	3.8	42.3	46.1

20. Intangible fixed assets continued

	Bank 2011 Internally generated intangible assets	Bank 2011 Other intangible assets	Bank 2011 Total	Bank 2010 Internally generated intangible assets	Bank 2010 Other intangible assets	Bank 2010 Total
Cost						
At the beginning of the year	**13.1**	**46.0**	**59.1**	17.3	46.0	63.3
Additions	**1.4**	**–**	**1.4**	2.7	–	2.7
Disposals	**(2.4)**	**–**	**(2.4)**	(6.9)	–	(6.9)
At the end of the year	**12.1**	**46.0**	**58.1**	13.1	46.0	59.1
Accumulated amortisation						
At the beginning of the year	**9.0**	**6.3**	**15.3**	14.7	3.7	18.4
Charge for the year	**1.4**	**4.5**	**5.9**	1.2	2.6	3.8
Disposals	**(2.4)**	**–**	**(2.4)**	(6.9)	–	(6.9)
At the end of the year	**8.0**	**10.8**	**18.8**	9.0	6.3	15.3
Net book value						
At the end of the year	**4.1**	**35.2**	**39.3**	4.1	39.7	43.8
At the beginning of the year	4.1	39.7	43.8	2.6	42.3	44.9

Internally generated intangible assets consist of software development costs.

Other intangible assets consist of a core deposit intangible of £44.0m and a brand intangible of £2.0m. The brand intangible has an indefinite useful life and is not amortised but is subject to an annual impairment review, using the same assumptions as those used for goodwill (note 19). On the basis of this review the brand is considered to be unimpaired.

21. Investment properties

	Group 2011	Group 2010
Fair value		
At the beginning of the year	**162.3**	137.7
Additions – acquisitions	**9.2**	21.6
Additions – subsequent expenditure	**2.1**	3.6
Disposals	**(0.8)**	(0.5)
Changes in fair value (note 7)	**(0.1)**	(0.1)
At the end of the year	**172.7**	162.3

All investment properties are held to generate rental income until such time that the Group considers it appropriate to realise its investment. Investment properties are carried at fair value.

The range of yields applied to the net annual rental income to determine the fair value of property is 3% to 8%.

The Group lets investment properties on Assured Shorthold Tenancy agreements, most of which are for contract periods of no more than 12 months. The future minimum lease receipts under non-cancellable operating leases are £3.0m (2010: £2.4m). The Group has not recognised any contingent rent in the year (2010: £nil). None of the lease agreements are individually significant.

Included in Group other operating income for the year is £7.9m (2010: £6.5m) of rental income relating to investment properties (note 7).

Notes to the financial statements continued
For the year ended 31 December 2011
All amounts are stated in £m unless otherwise indicated

22. Property, plant and equipment

2011 Group	Land and buildings	Leasehold improvements	Computers and other equipment	Total
Cost				
At the beginning of the year	**55.7**	**24.9**	**125.1**	**205.7**
Additions	**–**	**0.1**	**1.4**	**1.5**
Disposals	**–**	**–**	**(11.2)**	**(11.2)**
At the end of the year	**55.7**	**25.0**	**115.3**	**196.0**
Accumulated depreciation				
At the beginning of the year	**5.4**	**8.0**	**93.8**	**107.2**
Charge for the year	**1.2**	**5.4**	**13.0**	**19.6**
Disposals	**–**	**–**	**(10.9)**	**(10.9)**
At the end of the year	**6.6**	**13.4**	**95.9**	**115.9**
Net book value				
At the end of the year	**49.1**	**11.6**	**19.4**	**80.1**
At the beginning of the year	50.3	16.9	31.3	98.5

2010 Group	Land and buildings	Leasehold improvements	Computers and other equipment	Total
Cost				
At the beginning of the year	55.7	24.9	134.6	215.2
Additions	–	–	2.6	2.6
Disposals	–	–	(12.1)	(12.1)
At the end of the year	55.7	24.9	125.1	205.7
Accumulated depreciation				
At the beginning of the year	4.1	2.8	86.8	93.7
Charge for the year	1.3	5.2	18.3	24.8
Disposals	–	–	(11.3)	(11.3)
At the end of the year	5.4	8.0	93.8	107.2
Net book value				
At the end of the year	50.3	16.9	31.3	98.5
At the beginning of the year	51.6	22.1	47.8	121.5

22. Property, plant and equipment continued

2011 Bank	Land and buildings	Leasehold improvements	Computers and other equipment	Total
Cost				
At the beginning of the year	**34.8**	**24.8**	**121.0**	**180.6**
Additions	**–**	**0.1**	**0.9**	**1.0**
Disposals	**–**	**–**	**(10.8)**	**(10.8)**
At the end of the year	**34.8**	**24.9**	**111.1**	**170.8**
Accumulated depreciation				
At the beginning of the year	**2.2**	**7.9**	**91.4**	**101.5**
Charge for the year	**0.8**	**5.4**	**12.2**	**18.4**
Disposals	**–**	**–**	**(10.6)**	**(10.6)**
At the end of the year	**3.0**	**13.3**	**93.0**	**109.3**
Net book value				
At the end of the year	**31.8**	**11.6**	**18.1**	**61.5**
At the beginning of the year	32.6	16.9	29.6	79.1

2010 Bank	Land and buildings	Leasehold improvements	Computers and other equipment	Total
Cost				
At the beginning of the year	34.8	24.8	130.9	190.5
Additions	–	–	1.6	1.6
Disposals	–	–	(11.5)	(11.5)
At the end of the year	34.8	24.8	121.0	180.6
Accumulated depreciation				
At the beginning of the year	1.4	2.8	84.7	88.9
Charge for the year	0.8	5.1	17.4	23.3
Disposals	–	–	(10.7)	(10.7)
At the end of the year	2.2	7.9	91.4	101.5
Net book value				
At the end of the year	32.6	16.9	29.6	79.1
At the beginning of the year	33.4	22.0	46.2	101.6

	Group		**Bank**	
	2011	2010	**2011**	2010
The net book value of land and buildings comprises:				
Freehold	**48.6**	49.7	**31.3**	32.0
Leasehold	**0.5**	0.6	**0.5**	0.6
	49.1	50.3	**31.8**	32.6

Notes to the financial statements continued
For the year ended 31 December 2011
All amounts are stated in £m unless otherwise indicated

23. Other assets

	Group		Bank	
	2011	2010	**2011**	2010
Amounts recoverable within one year:				
Trade debtors	**23.2**	1.4	**23.2**	1.3
Current tax assets	**13.6**	–	**48.2**	–
Other assets	**9.8**	7.4	**6.1**	6.5
	46.6	8.8	**77.5**	7.8

The 2010 comparatives for the Group and Bank reflect a reclassification of £43.7m to derivatives from other assets.

24. Prepayments and accrued income

	Group		Bank	
	2011	2010	**2011**	2010
Amounts recoverable within one year:				
Other	**18.7**	16.2	**17.7**	14.5

25. Deposits by banks

	Group		Bank	
	2011	2010	**2011**	2010
Items in course of collection	**48.7**	45.3	**48.7**	45.3
Deposits from other banks	**3,254.0**	2,893.3	**3,191.1**	2,825.5
	3,302.7	2,938.6	**3,239.8**	2,870.8

Included within deposits from other banks are liabilities of £1,703.2m (2010: £1,349.1m) secured on investment securities with a carrying value of £2,114.4m (2010: £1,550.9m) which have been sold under sale and repurchase agreements (note 35).

26. Customer accounts

	Group		Bank	
	2011	2010	**2011**	2010
Retail	**26,429.2**	25,993.6	**25,631.2**	25,228.9
CABB	**7,648.4**	5,146.6	**6,684.1**	4,076.6
Other	**913.0**	1,179.8	**354.8**	606.5
	34,990.6	32,320.0	**32,670.1**	29,912.0

The Group has entered into interest rate swaps that protect it from changes in interest rates on the floating rate assets that are funded by its fixed rate customer accounts. Changes in the fair values of these swaps are offset by changes in the fair values of the fixed rate customer accounts. Included within customer accounts are 'fair value hedged' fixed rate accounts with a total nominal value of £3.0m (2010: £84.7m) against which there are fair value adjustments for hedged risk of £(0.4)m (2010: £0.2m), giving a total carrying value of £2.6m (2010: £84.9m).

27. Customer accounts – capital bonds

	Group		Bank	
	2011	2010	**2011**	2010
Retail	**1,429.8**	1,794.7	**1,397.3**	1,744.0

The capital bonds are fixed term customer accounts with returns based on the movement in an index (eg FTSE 100) over the term of the bond.

The capital bonds have been designated on initial recognition at fair value through income and expense and are carried at fair value.

The fair values for the capital bonds are obtained on a monthly basis from the swap counterparties. These external valuations are reviewed independently using valuation software to ensure the fair values are priced on a consistent basis.

None of the change in the fair value of the capital bonds is attributable to changes in the liability's credit risk.

The maximum amount the Group would contractually be required to pay at maturity for all the capital bonds is £1,429.6m (2010: £1,756.0m).

The Group uses swaps to create economic hedges against all of its capital bonds. The gain on capital bonds in the income statement for the year is £24.8m (2010: £28.5m). However, taking into account changes in fair value of the associated swaps, the net impact to the income statement for the year is a gain of £0.6m (2010: loss of £0.3m).

28. Debt securities in issue

	Group		Bank	
	2011	2010	**2011**	2010
Certificates of deposit	**252.1**	638.8	**252.1**	638.8
Commercial paper	**–**	20.1	**–**	20.1
Fixed and floating rate notes	**3,912.7**	3,553.3	**1,178.9**	1,197.9
	4,164.8	4,212.2	**1,431.0**	1,856.8

The Group has entered into cross currency interest rate swaps that protect it from changes in exchange rates and interest rates on its debt securities in issue. Changes in the fair values of these swaps are largely offset by changes in the sterling equivalent carrying value of the debt securities in issue.

Debt securities in issue include fixed and floating rate notes, the majority of which are secured on portfolios of variable and fixed rate mortgages. The notes are redeemable in part from time to time, such redemptions being limited to the net capital received from mortgagors in respect of the underlying assets. There is no requirement for the Group to make good any shortfall out of general funds. The maturity date of the notes matches the maturity date of the underlying assets.

29. Other borrowed funds

	Group and Bank	
	2011	2010
Step up callable subordinated notes 2019	**150.0**	150.0
60,000,000 9.25% non-cumulative irredeemable preference shares of £1 each	**60.0**	60.0
Floating rate subordinated notes 2016	**20.6**	104.1
5.625% fixed rate subordinated notes 2021	**150.0**	150.0
9.25% fixed rate subordinated notes 2021	**275.0**	–
Fixed rate subordinated notes 2024	**167.1**	144.0
Fixed rate subordinated notes 2033	**122.2**	99.1
Perpetual subordinated bonds	**282.9**	253.2
Issue costs, discounts and accrued interest	**31.0**	15.0
	1,258.8	975.4

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 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.

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 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.

Notes to the financial statements continued

For the year ended 31 December 2011

All amounts are stated in £m unless otherwise indicated

29. Other borrowed funds continued

Floating rate subordinated notes 2016

The notes were issued on 18 May 2006 at a discount of 0.14%.

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 are denominated in euros and interest is calculated at three months EURIBOR plus a margin of 0.28%. From 18 May 2011 interest has been calculated at three months EURIBOR plus a margin of 0.78%. The first interest coupon was paid in August 2006.

The notes were hedged with a cross currency swap converting the exposure into sterling which paid a floating rate of three months LIBOR with a margin on interest coupon of 0.34125% and received a floating rate of three months EURIBOR plus a margin on interest coupon of 0.28%. The cross currency swap matured on 18 May 2011.

On 28 April 2011 the Bank redeemed €149.2m of the notes (representing 81% of the amount outstanding) leaving €34.9m outstanding. The Bank had the option to call the outstanding notes in whole but not in part on the interest payment date falling on or nearest to May 2011, and now at any interest payment date thereafter subject to prior consent of the Financial Services Authority.

5.625% fixed rate subordinated notes 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 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 5.625% 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 three months 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.

9.25% fixed rate subordinated notes 2021

On 28 April 2011 the Bank issued £275.0m fixed rate subordinated notes due 2021, issued at par.

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 9.25% up to (but excluding) 28 April 2021. Interest is payable annually in April.

There is no option to redeem the notes early.

Fixed rate subordinated notes 2024

The notes were issued on 17 March 2004 at a discount of 1.148%.

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 5.75% to 2 December 2019 (reset date). During this period the notes are hedged with interest rate swaps that convert the interest rate payable into floating rates at six months LIBOR plus a margin of 0.72%. The fixed receipt leg of the swap is received annually to match the payment to the noteholders. The floating payment leg of the swap is payable semi-annually in June and December. The interest rate swaps mature on 2 December 2019.

From the reset date the interest rate will be calculated based on the Five Year Benchmark Gilt rate plus a margin of 1.94%. The Five Year Benchmark Gilt rate being the Gross Redemption Yield determined by the UK government security having a maturity date falling on or nearest the fifth anniversary of the determination date (the determination date being two days prior to the reset date), converted to an annualised yield. The Gross Redemption Yield being calculated on the basis set out by the UK Debt Management Office in the publication ‘Formulae for Calculating Gilt Prices from Yields’. From the reset date the interest will be paid annually in arrears until maturity or redemption.

The notes are callable in whole but not in part, at the principal amount, on 2 December 2019, subject to the prior consent of the Financial Services Authority.

Fixed rate subordinated notes 2033

The notes were issued on 28 March 2002 at a discount of 0.93%.

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% to maturity. Interest is payable semi-annually in March and September.

Of the notes, £100m are hedged with interest rate swaps that have a floating payment leg at six months LIBOR payable in March and September. The fixed interest rate receivable legs on the swaps are £25m at 5.405% and £75m at 5.225%. The semi-annual interest receivable leg on the swap is matched to the dates on the notes.

29. Other borrowed funds continued

Perpetual subordinated bonds

Perpetual subordinated bonds (PSBs) with a par value of £110m were issued in 1992 at a discount of 0%. PSBs with a par value of £200m were issued in 2005 at a discount of 0%.

Both the £110m and £200m PSBs are an unsecured obligation of the Bank and in the event of the winding up of the Bank, the claims of the bondholders will be subordinated in right of payment of all creditors (including subordinated creditors) of the Bank.

The PSBs with a par value of £110m carry an annual interest rate of 13%. Interest is payable semi-annually in January and July.

The PSBs with a par value of £200m carry an annual interest rate of 5.5555% up until the reset date. This coupon is payable semi-annually in June and December. From the reset date of 14 December 2015 the interest rate will be amended to the rate for three month deposits in sterling plus a margin of 2.05% per annum. The interest payments will then be made quarterly in arrears in March, June, September and December, with the interest resetting at each interest payment date.

During the period up until the reset date the PSBs are hedged with an interest rate swap that converts the interest rate payable into floating rates at six months LIBOR plus a margin of 1.175%. The semi-annual interest receivable and payable on the swap is aligned to the interest payment dates of the notes. The interest rate swap matures on 14 December 2015.

Given prior relevant supervisory consent, the Bank may elect to repay all, but not less than all, of these PSBs on 14 December 2015 or on any interest payment date thereafter at their principal amount.

30. Other liabilities

	Group		Bank	
	2011	2010	**2011**	2010
Amounts falling due within one year:				
ATM creditor	**122.4**	92.0	**122.4**	92.0
Other creditors	**46.5**	50.8	**42.2**	44.7
Amounts falling due after one year:				
Other creditors	**4.8**	4.0	**4.5**	3.8
	173.7	146.8	**169.1**	140.5

Other creditors of the Group and Bank include finance lease obligations as follows:

	Present value of lease payments		Future minimum lease payments	
	2011	2010	**2011**	2010
Due within one year	**–**	–	**–**	–
Due between one year and five years	**0.1**	0.1	**0.1**	0.1
Due after five years	**1.0**	1.3	**1.7**	1.7
	1.1	1.4	**1.8**	1.8

The future minimum lease payments have been discounted at LIBOR over the term of the lease to give the present value of these payments.

31. Accruals and deferred income

	Group		Bank	
	2011	2010	**2011**	2010
Amounts falling due within one year:				
Other	**34.6**	85.3	**27.9**	71.1
Amounts falling due after one year:				
Other	**5.3**	46.0	**5.2**	45.9
	39.9	131.3	**33.1**	117.0

Notes to the financial statements continued
For the year ended 31 December 2011
All amounts are stated in £m unless otherwise indicated

32. Provisions for liabilities and charges

2011 Group	Property	FSCS levies	PPI	Other	Total
At the beginning of the year	**8.8**	**20.9**	**4.3**	**21.8**	**55.8**
Income statement movements:					
Provided in the year – operating expense	**0.4**	**14.5**	**–**	**0.1**	**15.0**
Provided in the year – net fee and commission income	**–**	**–**	**90.0**	**1.0**	**91.0**
Released in the year – operating expense	**(0.3)**	**–**	**–**	**(0.1)**	**(0.4)**
Released in the year – net fee and commission income	**–**	**–**	**–**	**(0.9)**	**(0.9)**
Utilised during the year	**(2.0)**	**(10.4)**	**(32.6)**	**(13.5)**	**(58.5)**
At the end of the year	**6.9**	**25.0**	**61.7**	**8.4**	**102.0**
Provisions were analysed as follows:					
Amounts falling due within one year	**3.0**	**10.9**	**51.3**	**8.4**	**73.6**
Amounts falling due after one year	**3.9**	**14.1**	**10.4**	**–**	**28.4**
	6.9	**25.0**	**61.7**	**8.4**	**102.0**

2010 Group	Property	FSCS levies	PPI	Other	Total
At the beginning of the year	7.1	20.6	–	25.1	52.8
Income statement movements:					
Provided in the year – operating expense	3.4	11.5	–	3.5	18.4
Provided in the year – net fee and commission income	–	–	4.3	8.8	13.1
Released in the year – operating expense	(0.3)	–	–	(12.3)	(12.6)
Released in the year – net fee and commission income	–	–	–	–	–
Utilised during the year	(1.4)	(11.2)	–	(3.3)	(15.9)
At the end of the year	8.8	20.9	4.3	21.8	55.8
Provisions were analysed as follows:					
Amounts falling due within one year	1.2	10.6	4.3	19.8	35.9
Amounts falling due after one year	7.6	10.3	–	2.0	19.9
	8.8	20.9	4.3	21.8	55.8

2011 Bank	Property	FSCS levies	PPI	Other	Total
At the beginning of the year	**7.4**	**20.3**	**4.3**	**7.3**	**39.3**
Income statement movements:					
Provided in the year – operating expense	**0.4**	**14.5**	**–**	**–**	**14.9**
Provided in the year – net fee and commission income	**–**	**–**	**90.0**	**–**	**90.0**
Released in the year – operating expense	**(0.2)**	**–**	**–**	**–**	**(0.2)**
Released in the year – net fee and commission income	**–**	**–**	**–**	**(0.1)**	**(0.1)**
Utilised during the year	**(0.8)**	**(9.9)**	**(32.6)**	**(7.2)**	**(50.5)**
At the end of the year	**6.8**	**24.9**	**61.7**	**–**	**93.4**
Provisions were analysed as follows:					
Amounts falling due within one year	**2.9**	**10.8**	**51.3**	**–**	**65.0**
Amounts falling due after one year	**3.9**	**14.1**	**10.4**	**–**	**28.4**
	6.8	**24.9**	**61.7**	**–**	**93.4**

32. Provisions for liabilities and charges continued

2010 **Bank**	Property	FSCS levies	PPI	Other	Total
At the beginning of the year	5.4	20.1	–	19.5	45.0
Income statement movements:					
Provided in the year – operating expense	3.2	11.0	–	–	14.2
Provided in the year – net fee and commission income	–	–	4.3	–	4.3
Released in the year – operating expense	(0.2)	–	–	(12.2)	(12.4)
Released in the year – net fee and commission income	–	–	–	–	–
Utilised during the year	(1.0)	(10.8)	–	–	(11.8)
At the end of the year	7.4	20.3	4.3	7.3	39.3
Provisions were analysed as follows:					
Amounts falling due within one year	1.0	9.7	4.3	7.3	22.3
Amounts falling due after one year	6.4	10.6	–	–	17.0
	7.4	20.3	4.3	7.3	39.3

Property

The Group has a number of leasehold properties available for rent. Provisions are made when either the sub-lease income does not cover the rental expense or the property is vacant. The provision is based on the expected outflows during the remaining periods of the leases using a discount rate of 11%.

FSCS levies

In common with other FSA authorised financial institutions doing business in the UK, the Group contributes to the Financial Services Compensation Scheme (FSCS). The FSCS covers financial institutions authorised to do business in the UK. When an institution is unlikely, or likely to be unable, to pay claims against it, its customers may be able to claim compensation from the FSCS. The FSCS raises funds to meet the known compensation claims through levies on other FSA authorised institutions.

As a result of a number of institutions failing during 2008, the FSCS received funds from HM Treasury in order to meet its obligations to 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 each individual institution's proportion of the total market protected deposits at 31 December each year.

The Group has provided £25.0m (2010: £20.9m) for its share of the levies that will be raised by the FSCS, including the interest on the loan from the HM Treasury, in respect of the levy years ended 31 March 2012 and 31 March 2013.

At the date of these financial statements, it is not possible to estimate whether there will ultimately be 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 year.

The Financial Services Commission in the Isle of Man operates a similar scheme. Britannia International Limited has provided £nil for the year ended 31 December 2011 in respect of this scheme (2010: £0.3m).

PPI

Provisions have been made in respect of potential customer compensation claims relating to past sales of PPI. Claims are investigated on an individual basis and, where appropriate, compensation payments are made. For a number of years until January 2009, the Bank, along with many other financial services providers, sold PPI alongside non-mortgage credit products.

The FSA issued a policy statement in August 2010 which amended the 'Disputes Resolution: Complaints' section of the FSA Handbook, setting out new rules for handling complaints, including complaints of PPI mis-selling. The new rules were challenged by the BBA which launched a judicial review heard in January 2011. The results of the review were announced on 20 April 2011 and the High Court dismissed the BBA arguments. Consequently the Bank must comply with the policy statement which requires complainants to receive adequate redress and the Bank to complete a proactive review of all past business to identify mis-sold policies where no complaint has been made. An additional provision of £90.0m has been recognised in the year (note 5), in respect of the expected cost to the Bank of carrying out this work and paying compensation.

Other

The release of other provisions during 2010 relates to a disputed claim which was resolved during the year.

Notes to the financial statements continued
For the year ended 31 December 2011
All amounts are stated in £m unless otherwise indicated

33. Deferred tax
Deferred taxes are calculated on all temporary differences under the liability method using an effective tax rate of 25% (2010: 27%).

The movements on the deferred tax accounts are as follows:

	Group		Bank	
	2011	2010	**2011**	2010
Net deferred tax at the beginning of the year	**87.0**	86.1	**154.0**	210.3
Income statement charge	**(61.7)**	(2.5)	**(44.5)**	(57.8)
Prior year adjustments	**9.7**	2.1	**9.4**	0.2
Charged to equity:				
Unrealised appreciation on investments	**0.4**	–	**0.4**	–
Pensions and other post-retirement benefits	**(0.1)**	0.1	**(0.1)**	0.1
Cashflow hedges	**(8.9)**	1.2	**(8.9)**	1.2
Net deferred tax at the end of the year	**26.4**	87.0	**110.3**	154.0
Components of net deferred tax:				
Deferred tax asset	**137.5**	203.3	**110.3**	154.0
Deferred tax liability	**(111.1)**	(116.3)	**–**	–
	26.4	87.0	**110.3**	154.0
Net deferred tax comprises:				
Cashflow hedges	**(22.4)**	(13.4)	**(22.4)**	(13.4)
Unrealised appreciation on investments	**(0.7)**	(1.1)	**(0.7)**	(1.1)
Capital allowances on fixed assets	**28.5**	32.6	**29.4**	33.6
Capital allowances on assets leased to customers	**(2.7)**	(3.5)	**0.6**	0.2
Pensions and other post-retirement benefits	**0.9**	1.0	**0.9**	1.0
Fair value adjustments	**(3.4)**	34.5	**98.9**	129.0
Other temporary differences	**26.2**	36.9	**3.6**	4.7
	26.4	87.0	**110.3**	154.0

Other temporary differences for the Group of £26.2m (2010: £36.9m) include deferred tax assets/liabilities as a result of loss provisions on mortgage assets held by Special Purpose Entities (SPEs), taxation of SPEs under the securitisation regime and spreading of the tax effect of IFRS transitional adjustments.

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

	Group		Bank	
	2011	2010	**2011**	2010
Capital allowances on fixed assets	**4.0**	4.2	**4.1**	4.3
Capital allowances on assets leased to customers	**(0.7)**	(0.5)	**(0.2)**	(0.2)
Fair value adjustments	**35.7**	(44.3)	**27.8**	33.4
Other temporary differences	**13.0**	41.0	**3.4**	20.1
	52.0	0.4	**35.1**	57.6

The Budget on 23 March 2011 announced that the UK corporation tax rate would reduce from 28% to 23% over a period of four years. The first reduction in the UK corporation tax rate from 28% to 26% was substantively enacted on 29 March 2011 and was effective from 1 April 2011. The budget on 21 March 2012 announced that the UK corporation tax rate would reduce by an additional one percent to 24% from April 2012 with further reductions to 23% in 2013 and 22% in 2014. These rate changes will reduce the Group's future current tax charge accordingly. The reduction in the UK corporation tax rate from 26% to 25% with effect from 1 April 2012 was substantively enacted on 5 July 2011. The tax disclosures for the period reflect deferred tax at the 25% substantively enacted rate at the balance sheet date. It has not yet been possible to quantify the full anticipated effect of the further rate reduction, although this will further reduce the Group's future tax charge and reduce the Group's deferred tax assets/liabilities.

The Group has traded profitably and expects that the deferred tax asset will be recoverable against future profits.

34. Pensions

Defined contribution basis

The Group participates 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, based on a fixed percentage as agreed with the trustees.

Key assumptions of the Group pension scheme

The key aspects of the PACE scheme are as follows:

	2011	2010
The principal assumptions used to determine the liabilities of the PACE scheme are:		
Discount rate	**4.60%**	5.20%
Rate of increase in salaries	**4.80%**	5.20%
Future pension increases where capped at 5.0% per annum	**3.30%**	3.70%
Future pension increases where capped at 2.5% per annum	**2.50%**	2.50%
Assumptions used to determine net pension cost for the PACE scheme are:		
Discount rate	**5.20%**	5.60%
Expected long term return on scheme assets	**6.20%**	6.50%
Rate of increase in salaries	**5.20%**	5.30%

The average life expectancy (in years) for mortality tables used to determine scheme liabilities for the PACE scheme at the 2011 year end is:

	Male	Female
Life expectancy:		
Member currently aged 65 (current life expectancy)	**21.9**	**23.4**
Member currently aged 45 (life expectancy at age 65)	**23.3**	**25.0**

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

	2011	2010
Present value of funded obligations	**(6,242.6)**	(5,794.2)
Present value of unfunded obligations	**(4.4)**	(4.1)
Fair value of plan assets	**6,610.5**	6,071.3
	363.5	273.0

The weighted average asset allocations at the year end were as follows:

	2011	2010
Equities	**29%**	31%
Liability driven investments	**51%**	54%
Alternative growth	**14%**	9%
Property	**5%**	4%
Cash	**1%**	2%

To develop the expected long term rate of return on assets assumption, The Co-operative 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 6.2% assumption for the year ended 31 December 2011 (2010: 6.5%).

Notes to the financial statements continued
For the year ended 31 December 2011
All amounts are stated in £m unless otherwise indicated

34. Pensions continued
Former Britannia Building Society pension scheme
Following the transfer of engagements of Britannia Building Society, the Britannia pension scheme transferred to the Co-operative Financial Services Management Services Limited (CFSMS). The pension cost shown in these accounts in respect of the Britannia defined benefit scheme for the period after 31 July 2009 is the actual contribution paid by the Bank.

The key aspects of the Britannia defined benefit scheme are as follows:

	2011	2010
The principal assumptions used to determine the liabilities of the Britannia defined benefit scheme are:		
Discount rate	**4.60%**	5.20%
Rate of increase in salaries	**4.80%**	5.20%
Future pension increases where capped at 5.0% per annum	**3.30%**	3.70%
Future pension increases where capped at 2.5% per annum	**2.50%**	2.50%
Assumptions used to determine net pension cost for the Britannia defined benefit scheme are:		
Discount rate	**5.20%**	5.60%
Expected long term return on scheme assets	**6.00%**	6.20%
Rate of increase in salaries	**5.20%**	5.30%

The average life expectancy (in years) for mortality tables used to determine defined benefit scheme liabilities for the former Britannia Building Society scheme at the 2011 year end is:

	Male	Female
Life expectancy:		
Member currently aged 65 (current life expectancy)	**23.5**	**25.8**
Member currently aged 40 (life expectancy at age 60)	**25.0**	**27.4**

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

	2011	2010
Present value of funded obligations	**(608.4)**	(549.4)
Present value of unfunded obligations	**(2.9)**	(5.6)
Fair value of plan assets	**569.9**	509.2
	(41.4)	(45.8)

The weighted average asset allocations at the year end were as follows:

	2011	2010
Equities	**25%**	28%
Diversified growth	**15%**	17%
Liability driven investments	**57%**	54%
Property	**3%**	1%

To develop the expected long term rate of return on assets assumption, The Co-operative 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 6.0% assumption for the year ended 31 December 2011 (2010: 6.2%).

34. Pensions continued

Bank (unfunded) pension scheme

The Bank also operates a small unfunded pension scheme.

	2011	2010	2009	2008	2007
Expected return on scheme assets	**N/A**	N/A	N/A	N/A	N/A
Rate of increase of pensions in payment	**3.3%**	3.7%	3.8%	3.3%	3.4%
Rate of increase in salaries	**4.8%**	5.2%	5.3%	4.8%	4.9%
Discount rate	**4.6%**	5.2%	5.6%	5.7%	5.7%

The values of the assets and liabilities of the unfunded pension scheme were:

	Group and Bank	
	2011	2010
Present value of unfunded obligations	**(3.9)**	(3.8)
Deficit in scheme	**(3.9)**	(3.8)
Related deferred tax asset	**0.9**	1.0
Net pension liability	**(3.0)**	(2.8)
Analysis of amount charged to income statement:		
Current service cost	**–**	–
Interest on pension scheme liabilities	**0.2**	0.2
	0.2	0.2

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

	Group and Bank	
	2011	2010
Opening defined benefit liabilities	**3.8**	3.5
Current service cost	**–**	–
Interest on liabilities	**0.2**	0.2
Actuarial losses	**–**	0.4
Benefits paid	**(0.1)**	(0.3)
Closing defined benefit liabilities	**3.9**	3.8

Amounts recognised in the statement of comprehensive income:

	Group and Bank	
	2011	2010
Actuarial losses on scheme liabilities during the year	**–**	(0.4)
Actuarial gains on scheme assets during the year	**–**	–
Total scheme losses during the year	**–**	(0.4)

The amounts for the current year are as follows:

	Group and Bank	
	2011	2010
Defined benefit obligation	**(3.9)**	(3.8)
Scheme assets	**–**	–
Deficit in scheme	**(3.9)**	(3.8)
Experience adjustment on scheme liabilities	**–**	–
Experience adjustment on scheme assets	**–**	–

Notes to the financial statements continued
For the year ended 31 December 2011
All amounts are stated in £m unless otherwise indicated

35. Contingent liabilities and commitments
The tables below give, for the Group and the Bank, the contract amounts and risk weighted amounts of contingent liabilities and commitments. The contract principal amounts indicate the volume of business outstanding at the balance sheet date and do not represent amounts at risk. The risk weighted amounts have been calculated in accordance with the 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 2011	Risk weighted amount 2011	Contract amount 2010	Risk weighted amount 2010
Group				
Contingent liabilities:				
Guarantees and irrevocable letters of credit	**167.6**	**131.8**	134.2	99.1
Bank				
Contingent liabilities:				
Guarantees and irrevocable letters of credit	**166.6**	**131.3**	132.8	98.4
Group				
Other commitments:				
Documentary credits and short term trade related transactions	**7.7**	**1.5**	2.8	0.5
Forward asset purchases and forward deposits placed	**44.9**	**0.9**	165.8	14.6
Undrawn formal standby facilities, credit lines and other commitments to lend (includes revocable and irrevocable commitments)[(i)]	**4,700.1**	**1,148.1**	4,590.9	1,089.3
	4,752.7	**1,150.5**	4,759.5	1,104.4
Bank				
Other commitments:				
Documentary credits and short term trade related transactions	**7.7**	**1.5**	2.8	0.5
Forward asset purchases and forward deposits placed	**44.9**	**0.9**	165.8	14.6
Undrawn formal standby facilities, credit lines and other commitments to lend (includes revocable and irrevocable commitments)[(i)]	**4,504.2**	**1,138.7**	4,450.9	1,081.5
	4,556.8	**1,141.1**	4,619.5	1,096.6

Notes

(i) Undrawn loan commitments include revocable commitments which are unused credit card limits of £2,181.6m (2010: £2,344.9m).

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

At 31 December 2011, the mandatory reserve deposits held with the Bank of England were £38.0m (2010: £36.1m) (note 13).

Within the Group and Bank, investment securities with a carrying value of £2,114.4m (2010: £1,550.9m) have been sold under sale and repurchase agreements. These assets have not been derecognised as the Group and Bank have retained substantially all the risks and rewards of ownership. Included within deposits by banks are the related liabilities of £1,703.2m (2010: £1,349.1m).

In addition, within the Bank, amounts owed by other Co-operative Group undertakings with a carrying value of £777.1m (2010: £988.6m) have been sold under sale and repurchase agreements. These assets have not been derecognised as the Bank has retained substantially all the risks and rewards of ownership. Included within deposits by banks are the related liabilities of £613.9m (2010: £778.6m).

The Group and Bank have loans and advances to banks of £255.7m (2010: £70.0m) under reverse sale and repurchase agreements and against which it holds gilts with a fair value of £267.8m (2010: £70.0m). These transactions are conducted under terms that are usual and customary to standard stock lending, securities borrowing and reverse purchase agreements. The Group is permitted to sell or repledge the assets received as collateral in the absence of their default. The Group is obliged to return equivalent securities. At 31 December 2011 the fair value of collateral repledged amounted to £267.8m (2010: £70.0m). The Group and Bank do not adjust for the fair value of securities received under reverse sale and repurchase agreements.

35. Contingent liabilities and commitments continued

Commitments under operating leases

The Group leases various properties and equipment under non-cancellable operating lease arrangements. The leases have various terms, ranging from six months to 999 years. None of these leases are individually material and none have any material clauses. The table below discloses the minimum operating lease payments the Group and the Bank will be required to make over the remaining lives of the leases.

	Land and buildings 2011	Equipment 2011	Land and buildings 2010	Equipment 2010
Group				
Falling due:				
Within one year	**26.1**	**0.3**	24.4	0.4
Between one and five years	**76.5**	**0.4**	78.6	0.4
In five years or more	**87.3**	**0.1**	103.5	–
	189.9	**0.8**	206.5	0.8
Bank				
Falling due:				
Within one year	**25.4**	**0.3**	24.0	0.4
Between one and five years	**78.7**	**0.4**	75.9	0.4
In five years or more	**73.7**	**0.1**	84.5	–
	177.8	**0.8**	184.4	0.8

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 three to five years to reflect market rentals.

The total value of future minimum sub-lease payments expected to be received under non-cancellable sub-leases for the Group was £12.8m (2010: £13.4m) and for the Bank was £12.8m (2010: £12.2m).

Former Britannia Building Society pension scheme guarantee

Following the transfer of engagements of Britannia Building Society, the Britannia pension scheme transferred to CFSMS. Under the terms of this transfer the Bank entered into a deed of guarantee to provide assurance to the trustees of the pension scheme to support CFSMS in meeting its funding obligations to the scheme should CFSMS be unable to pay its obligations as they fall due.

Intra-group guarantee

The Bank has an indemnification agreement, accounted for as an intra-group guarantee under IFRS 4, with CFSMS in which the Bank has agreed to indemnify CFSMS against all and any liability, loss, damage, costs and expense arising from the agreement.

36. Investments in Group undertakings

Investments in equity shares and loans of subsidiary undertakings are financial assets.

	2011			2010		
	Ordinary shares	**Capital contributions**	**Total**	Ordinary shares	Capital contributions	Total
At the beginning of the year	**569.0**	**889.9**	**1,458.9**	576.4	996.0	1,572.4
Additions	**1.0**	**1,057.8**	**1,058.8**	11.5	386.0	397.5
Impairment of investment in Co-operative Bank Financial Advisers Limited	**–**	**–**	**–**	(18.9)	–	(18.9)
Repayments	**(0.3)**	**(944.0)**	**(944.3)**	–	(492.1)	(492.1)
At the end of the year	**569.7**	**1,003.7**	**1,573.4**	569.0	889.9	1,458.9

Subsidiary undertakings

The Bank has, except in the case of Unity Trust Bank plc, a direct interest in the ordinary share capital of the following principal subsidiary undertakings trading in the businesses indicated. All subsidiary undertakings are included in the consolidated Group results.

Notes to the financial statements continued
For the year ended 31 December 2011
All amounts are stated in £m unless otherwise indicated

36. Investments in Group undertakings continued
Principal subsidiary undertakings which are registered in England and operating in the UK:

		Group interest 2011	Group interest 2010
Unity Trust Bank plc (held through subsidiary undertaking)	Banking	**27%**	27%
Co-operative Commercial Limited	Investment company	**100%**	100%
First Roodhill Leasing Limited	Leasing	**100%**	100%
Second Roodhill Leasing Limited	Leasing	**100%**	100%
Third Roodhill Leasing Limited	Leasing	**100%**	100%
Fourth Roodhill Leasing Limited	Leasing	**100%**	100%
The Covered Bond LLP	Mortgage acquisition and guarantor of covered bonds	**100%**	100%
Britannia Treasury Services Limited	Holding company	**100%**	100%
Britannia Asset Management Limited	Holding company	**100%**	100%
Britannia Development and Management Company Limited	Property investment	**100%**	100%
Illius Properties Limited	Property investment	**100%**	100%
Moorland Covered Bonds LLP	Mortgage acquisition and guarantor of covered bonds	**100%**	100%

The Covered Bond LLP was established as a result of a £1.0bn covered bond retained issuance by the Bank during 2008. Loans and advances to customers of £2.3bn were transferred to the LLP. The transfer was funded by a loan of £1.0bn and capital contribution of £1.3bn. This issuance was redeemed during the year.

Moorland Covered Bonds LLP was established as a result of a £1.4bn covered bond retained issuance. Loans and advances to customers of £1.9bn were transferred to Moorland Covered Bonds LLP. The transfer was funded by a loan of £1.4bn and capital contribution of £0.5bn. During October 2011 the £1.4bn loan was repaid. Following additional capital contribution repayment and on achieving Regulated Covered Bond status there was a public issuance of notes in November 2011 totalling £0.6bn. As a result of these changes at the year end the Bank held a loan of £0.6bn and a capital contribution of £1.0bn with Moorland Covered Bonds LLP.

The loans issued by the Bank are included within amounts owed by other Co-operative Group undertakings. The associated capital contribution invested by the Bank is included within investments in Group undertakings. The notes issued by the Bank in November 2011 are included within debt securities in issue.

The Covered Bond LLP and Moorland Covered Bonds LLP do not have ordinary share capital. The Bank's interest in The Covered Bond LLP and Moorland Covered Bonds LLP is in substance no different from a wholly owned subsidiary and consequently they are fully consolidated in the Group accounts.

The accounting policy for Special Purpose Entities (SPEs) is disclosed on page 39.

Unity Trust Bank plc is considered to be a subsidiary undertaking of The Co-operative Bank plc as The Co-operative Bank plc elects a majority of the directors and appoints the chair and managing director. This provides the power to control.

Investments in equity shares and loans with subsidiary undertakings are shown net of impairments.

Britannia Treasury Services Limited has the following principal wholly owned subsidiary undertakings, registered in England, operating in the UK and trading in the businesses indicated:

Mortgage Agency Services Number One Limited	Mortgage and syndicated lending
Mortgage Agency Services Number Two Limited	Mortgage lending
Mortgage Agency Services Number Four Limited	Mortgage lending
Mortgage Agency Services Number Five Limited	Mortgage lending
Mortgage Agency Services Number Six Limited	Mortgage lending
Western Mortgage Services Limited	Mortgage book administration
Platform Group Holdings Limited	Holding company

Platform Group Holdings Limited has the following principal wholly owned subsidiary undertakings, registered in England, operating in the UK and trading in the businesses indicated:

Platform Consumer Services Limited	Mortgage lending
Platform Funding Limited	Mortgage origination
Platform Home Loans Limited	Mortgage origination and servicing

Platform Consumer Services Limited is the only direct subsidiary of Platform Group Holdings Limited.

Registered in the Isle of Man and operating overseas:

Britannia International Limited	Deposit taking

36. Investments in Group undertakings continued

Registered in Scotland and operating in the UK:

Britannia Life Direct Limited	Direct sales of financial services

Securitisation vehicles

The results of the following principal securitisation vehicles are consolidated into the results of the Group under SIC 12 (Consolidation: Special Purpose Entities):

Leek Finance Number Seventeen plc	Securitisation company
Leek Finance Number Eighteen plc	Securitisation company
Leek Finance Number Nineteen plc	Securitisation company
Leek Finance Number Twenty plc	Securitisation company
Leek Finance Number Twenty One plc	Securitisation company
Leek Finance Number Twenty Two plc	Securitisation company
Meerbrook Finance Number One Limited	Securitisation company
Meerbrook Finance Number Two Limited	Securitisation company
Meerbrook Finance Number Three Limited	Securitisation company
Meerbrook Finance Number Four Limited	Securitisation company
Meerbrook Finance Number Six Limited	Securitisation company
Dovedale Finance Number One plc	Securitisation company
Silk Road Finance Number One plc	Securitisation company
Silk Road Finance Number Two plc	Securitisation company

All securitisation vehicles are registered in England and operate in the UK, with the exception of Dovedale Finance Number One plc, which is registered and operates in the Republic of Ireland.

All of the above companies are related parties to the Group. See note 37 for the related party disclosures.

Joint ventures

The Group's investment in joint ventures is £2.7m (2010: £2.5m).

The Bank owns 49% of the ordinary shares in Britannia Personal Lending Limited, a company registered in England and operating in the UK. The company trades in the business of unsecured personal lending.

The Group's interest in Britannia Personal Lending Limited is as follows:

	2011	2010
Current assets	**17.5**	21.7
Long term assets	**13.0**	22.6
	30.5	44.3
Current liabilities	**20.2**	27.3
Long term liabilities	**10.3**	17.0
	30.5	44.3
Income	**1.3**	2.5
Expenses	**(1.1)**	(1.5)
Profit before tax	**0.2**	1.0
Taxation	**–**	(0.3)
Profit after tax	**0.2**	0.7

Joint ventures are accounted for using the equity method.

Notes to the financial statements continued
For the year ended 31 December 2011
All amounts are stated in £m unless otherwise indicated

37. Related party transactions
Parent, subsidiary and ultimate controlling party
The Co-operative Banking Group Limited (previously the Co-operative Financial Services Limited) owns 100% of the issued ordinary share capital of the Bank and is the Bank's immediate holding company. The Co-operative Banking Group 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, which is incorporated in England and 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.

Further details of subsidiary undertakings and joint ventures are disclosed in note 36.

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 as defined by IAS 24 (Related Party Disclosures) are considered to be Board and executive members of the Group, and Board and executive members 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:

Directors, key management personnel and close family members

	Group and Bank	
	2011	2010
Loans outstanding at the beginning of the year	**2.3**	3.1
Net movement	**(0.1)**	(0.8)
Loans outstanding at the end of the year	**2.2**	2.3
Deposits and investments at the beginning of the year	**2.0**	2.0
Net movement	**(0.1)**	–
Deposits and investments at the end of the year	**1.9**	2.0

Directors' loans

	Mortgages 2011	**Personal loans 2011**	**Credit cards 2011**	Mortgages 2010	Personal loans 2010	Credit cards 2010
Number of directors with loan type	**6**	**1**	**9**	8	–	11
Total value of directors' loans	**1.8**	**–**	**–**	2.2	–	–

The Bank undertook the following transactions with Group companies during the year:

	Interest paid to Bank	**Interest received from Bank**	**Staff recharges paid to Bank**	**Rent received from Bank**	**Administration recharge paid to Bank**
2011					
First Roodhill Leasing Limited	**–**	**0.2**	**–**	**–**	**–**
Second Roodhill Leasing Limited	**0.2**	**–**	**–**	**–**	**–**
Third Roodhill Leasing Limited	**0.3**	**–**	**–**	**–**	**–**
The Covered Bond LLP	**9.1**	**9.3**	**–**	**–**	**–**
Britannia Treasury Services Limited	**0.2**	**–**	**–**	**–**	**–**
Britannia Development and Management Company Limited	**–**	**–**	**–**	**0.6**	**–**
Britannia Asset Management Limited	**–**	**0.3**	**–**	**–**	**–**
Mortgage Agency Services Number One Limited	**17.6**	**–**	**–**	**–**	**–**
Mortgage Agency Services Number Two Limited	**0.4**	**–**	**–**	**–**	**–**
Mortgage Agency Services Number Four Limited	**1.3**	**–**	**0.1**	**–**	**–**
Mortgage Agency Services Number Five Limited	**2.9**	**–**	**0.4**	**–**	**–**
Mortgage Agency Services Number Six Limited	**0.3**	**–**	**–**	**–**	**–**
Platform Group Holdings Limited	**39.0**	**–**	**8.6**	**–**	**–**
Britannia International Limited	**–**	**40.5**	**–**	**–**	**–**
Britannia Life Direct Limited	**–**	**0.8**	**–**	**–**	**–**
Illius Properties Limited	**4.0**	**–**	**0.3**	**–**	**–**
Moorland Covered Bonds LLP	**18.5**	**42.5**	**–**	**–**	**–**
Other	**–**	**0.7**	**–**	**–**	**–**

37. Related party transactions continued

	Interest paid to Bank	Interest received from Bank	Staff recharges paid to Bank	Rent received from Bank	Administration recharge paid to Bank
2010					
First Roodhill Leasing Limited	–	0.1	–	–	–
Second Roodhill Leasing Limited	0.2	–	–	–	–
Third Roodhill Leasing Limited	0.3	–	–	–	–
Fourth Roodhill Leasing Limited	0.1	–	–	–	–
The Covered Bond LLP	11.9	12.0	–	–	–
Britannia Treasury Services Limited	0.3	–	–	–	–
Britannia Development and Management Company Limited	–	–	–	0.6	–
Britannia Asset Management Limited	–	0.3	–	–	–
Mortgage Agency Services Number One Limited	17.8	–	0.1	–	–
Mortgage Agency Services Number Two Limited	0.4	–	–	–	–
Mortgage Agency Services Number Four Limited	1.3	–	0.1	–	–
Mortgage Agency Services Number Five Limited	3.0	–	1.1	–	–
Mortgage Agency Services Number Six Limited	0.1	–	–	–	–
Platform Group Holdings Limited	44.2	–	–	–	–
Britannia International Limited	–	39.5	–	–	–
Britannia Life Direct Limited	–	0.7	–	–	–
Illius Properties Limited	3.5	–	1.0	–	–
Moorland Covered Bonds LLP	17.0	53.7	–	–	–
Other	–	0.5	–	–	7.6

Interest accrues on outstanding balances at a transfer price rate agreed between the Bank and its subsidiaries.

	Interest and fees received from other Co-operative Group undertakings 2011	**Interest and fees paid to other Co-operative Group undertakings 2011**	Interest and fees received from other Co-operative Group undertakings 2010	Interest and fees paid to other Co-operative Group undertakings 2010
Parent undertakings	**4.6**	**1.0**	5.7	0.5
Fellow subsidiary undertakings	**1.1**	**–**	2.1	–
	5.7	**1.0**	7.8	0.5

Notes to the financial statements continued
For the year ended 31 December 2011
All amounts are stated in £m unless otherwise indicated

37. Related party transactions continued
At the year end the following unsecured balances were outstanding:

	Loans owed to Bank 2011	**Loans owed by Bank 2011**	Loans owed to Bank 2010	Loans owed by Bank 2010
Co-operative Commercial Limited	**0.5**	**–**	1.0	–
First Roodhill Leasing Limited	**–**	**3.8**	–	3.1
Second Roodhill Leasing Limited	**2.8**	**–**	3.5	–
Third Roodhill Leasing Limited	**3.7**	**–**	5.4	–
Fourth Roodhill Leasing Limited	**–**	**0.7**	0.7	–
The Covered Bond LLP	**–**	**–**	1,000.0	1,432.6
Unity Trust Bank plc	**–**	**102.8**	–	78.1
Britannia Treasury Services Limited	**8.4**	**–**	34.4	–
Britannia Development and Management Company Limited	**–**	**2.8**	–	2.3
Britannia Asset Management Limited	**–**	**40.1**	–	39.9
Mortgage Agency Services Number One Limited	**1,919.1**	**–**	2,169.3	–
Mortgage Agency Services Number Two Limited	**46.8**	**–**	55.9	–
Mortgage Agency Services Number Four Limited	**152.1**	**–**	165.7	–
Mortgage Agency Services Number Five Limited	**319.4**	**–**	365.6	–
Mortgage Agency Services Number Six Limited	**29.9**	**–**	33.4	–
Platform Group Holdings Limited	**3,297.4**	**–**	2,929.6	–
Britannia International Limited	**–**	**1,848.2**	–	1,931.3
Britannia Life Direct Limited	**–**	**101.6**	–	95.5
Western Mortgage Services Limited	**–**	**0.4**	0.7	–
Illius Properties Limited	**155.3**	**–**	144.1	–
Moorland Covered Bonds LLP	**616.8**	**1,562.1**	1,422.5	1,827.8
Other	**5.8**	**11.8**	5.6	12.5

Group	**Loans owed by other Co-operative Group undertakings 2011**	**Loans owed to other Co-operative Group undertakings 2011**	Loans owed by other Co-operative Group undertakings 2010	Loans owed to other Co-operative Group undertakings 2010
Parent undertakings	**1.6**	**74.0**	–	110.5
Fellow subsidiary undertakings	**177.6**	**58.3**	0.6	78.0
	179.2	**132.3**	0.6	188.5

Bank	**Loans owed by other Co-operative Group undertakings 2011**	**Loans owed to other Co-operative Group undertakings 2011**	Loans owed by other Co-operative Group undertakings 2010	Loans owed to other Co-operative Group undertakings 2010
Parent undertakings	**1.6**	**74.0**	–	110.5
Fellow subsidiary undertakings	**180.5**	**58.3**	0.6	78.0
	182.1	**132.3**	0.6	188.5

There are no formal repayment terms with subsidiary companies.

Recharges from CFSMS
During the year, operating costs of £488.6m (2010: £433.5m) incurred on its behalf were charged at cost to the Bank by CFSMS, a fellow subsidiary of the Co-operative Banking Group Limited. At 31 December 2011, the Bank was owed £180.5m by CFSMS. At 31 December 2010, the Bank owed £4.4m to CFSMS.

37. Related party transactions continued

Transactions with SPEs

The Bank undertook the following transactions with SPEs during the year:

	Interest paid to Bank 2011	**Interest received from Bank 2011**	Interest paid to Bank 2010	Interest received from Bank 2010
Leek Finance Number Seventeen plc	**3.7**	**2.3**	1.3	–
Leek Finance Number Eighteen plc	**4.7**	**3.1**	1.2	–
Leek Finance Number Nineteen plc	**4.8**	**3.0**	1.1	–
Leek Finance Number Twenty plc	**27.5**	**–**	26.4	–
Leek Finance Number Twenty One plc	**18.3**	**–**	17.7	–
Leek Finance Number Twenty Two plc	**7.7**	**–**	7.4	–
Meerbrook Finance Number One Limited	**0.2**	**–**	0.6	–
Meerbrook Finance Number Three Limited	**0.3**	**–**	0.3	–
Meerbrook Finance Number Four Limited	**8.1**	**0.7**	6.9	0.5
Meerbrook Finance Number Six Limited	**0.2**	**–**	0.1	–
Silk Road Finance Number One plc	**26.4**	**–**	24.4	–
Silk Road Finance Number Two plc	**1.2**	**–**	–	–
Other	**–**	**–**	1.1	–

	Fees paid to Bank 2011	**Fees received from Bank 2011**	Fees paid to Bank 2010	Fees received from Bank 2010
Silk Road Finance Number One plc	**2.0**	**–**	2.0	–
Silk Road Finance Number Two plc	**0.4**	**–**	–	–
Other	**–**	**–**	–	2.2

At the year end the following balances were outstanding with SPEs:

	Loans owed to Bank 2011	**Loans owed by Bank 2011**	Loans owed to Bank 2010	Loans owed by Bank 2010
Leek Finance Number Seventeen plc	**186.8**	**164.2**	22.3	2.1
Leek Finance Number Eighteen plc	**243.8**	**206.1**	13.4	0.3
Leek Finance Number Nineteen plc	**235.6**	**203.1**	35.0	0.3
Leek Finance Number Twenty plc	**1,667.4**	**2.5**	1,757.1	2.5
Leek Finance Number Twenty One plc	**1,118.9**	**0.9**	1,200.0	2.6
Leek Finance Number Twenty Two plc	**464.8**	**1.0**	487.1	1.6
Meerbrook Finance Number One Limited	**14.0**	**0.9**	41.5	27.8
Meerbrook Finance Number Two Limited	**–**	**0.1**	–	0.1
Meerbrook Finance Number Three Limited	**10.1**	**2.5**	10.1	2.8
Meerbrook Finance Number Four Limited	**682.2**	**109.6**	727.1	109.1
Meerbrook Finance Number Six Limited	**15.8**	**3.6**	15.8	4.5
Silk Road Finance Number One plc	**1,382.6**	**2,128.1**	1,586.4	2,574.4
Silk Road Finance Number Two plc	**199.1**	**828.3**	–	–
Dovedale Finance Number One plc	**–**	**0.5**	–	0.4
Other	**–**	**3.2**	–	1.0

In addition to the above the Bank holds floating rate notes in Leek Finance Number Seventeen plc of £18.5m (2010: £12.7m), in Leek Finance Number Eighteen plc of £23.3m (2010: £18.2m) and in Leek Finance Number Nineteen plc of £28.7m (2010: £21.7m) included within investment securities – available for sale.

The loans owed to the SPEs comprise cash balances deposited with the Bank.

Notes to the financial statements continued

For the year ended 31 December 2011

All amounts are stated in £m unless otherwise indicated

37. Related party transactions continued

Key management compensation

	Group and Bank	
	2011	2010
Salaries and short term benefits	**4.6**	5.4
Termination benefits	**2.5**	–
	7.1	5.4

Directors' remuneration

A list of the members of the Board of directors is shown on page 10. The total remuneration of directors was £3.7m (2010: £4.5m).

Further details of directors' remuneration are provided in the remuneration report on pages 19 to 28.

38. Share capital

	Group and Bank			
	No. of shares (millions) 2011	**Share capital 2011**	No. of shares (millions) 2010	Share capital 2010
Authorised capital (ordinary shares of 5p each)				
At the beginning of the year	**8,200**	**410.0**	4,600	230.0
Increase in the year	**–**	**–**	3,600	180.0
At the end of the year	**8,200**	**410.0**	8,200	410.0
Allotted, called up and fully paid (ordinary shares of 5p each)				
At the beginning of the year	**8,200**	**410.0**	4,600	230.0
Issued in the year	**–**	**–**	3,600	180.0
At the end of the year	**8,200**	**410.0**	8,200	410.0
Share premium account at the beginning and the end of the year		**8.8**		8.8

On 15 December 2010, the Bank issued 3,600,000,000 ordinary shares of 5p each at a cost of £180.0m. These were issued to its immediate parent company, the Co-operative Banking Group Limited.

The shareholders have one vote for every share held.

39. Fair values of financial assets and liabilities

The tables below analyse the balance sheet carrying values of financial assets and liabilities by classification.

Balance sheet categories	Held for trading	Designated at fair value	Loans and receivables	Available for sale	Liabilities at amortised cost	Cashflow hedges	Total
2011							
Group							
Assets							
Cash and balances at central banks	–	–	6,696.6	–	–	–	6,696.6
Loans and advances to banks	–	–	2,006.5	–	–	–	2,006.5
Loans and advances to customers	–	114.1	34,018.2	–	–	–	34,132.3
Investment securities	–	343.1	804.9	3,423.0	–	–	4,571.0
Derivative financial instruments	163.7	593.6	–	–	–	218.5	975.8
Equity shares	–	–	–	5.7	–	–	5.7
Amounts owed by other Co-operative Group undertakings	–	–	179.2	–	–	–	179.2
Total financial assets	163.7	1,050.8	43,705.4	3,428.7	–	218.5	48,567.1
Non-financial assets							388.5
Total assets							48,955.6
Liabilities							
Deposits by banks	–	–	–	–	3,302.7	–	3,302.7
Customer accounts	–	–	–	–	34,990.6	–	34,990.6
Customer accounts – capital bonds	–	1,429.8	–	–	–	–	1,429.8
Debt securities in issue	–	–	–	–	4,164.8	–	4,164.8
Derivative financial instruments	143.5	838.2	–	–	–	106.2	1,087.9
Other borrowed funds	–	–	–	–	1,258.8	–	1,258.8
Amounts owed to other Co-operative Group undertakings	–	–	–	–	132.3	–	132.3
Total financial liabilities	143.5	2,268.0	–	–	43,849.2	106.2	46,366.9
Non-financial liabilities							315.6
Total liabilities							46,682.5
Capital and reserves							2,273.1
Total liabilities and equity							48,955.6

Notes to the financial statements continued
For the year ended 31 December 2011
All amounts are stated in £m unless otherwise indicated

39. Fair values of financial assets and liabilities continued

Balance sheet categories	Held for trading	Designated at fair value	Loans and receivables	Available for sale	Liabilities at amortised cost	Cashflow hedges	Total
2010							
Group							
Assets							
Cash and balances at central banks	–	–	1,735.6	–	–	–	1,735.6
Loans and advances to banks	–	–	2,394.1	–	–	–	2,394.1
Loans and advances to customers	–	74.1	35,070.0	–	–	–	35,144.1
Investment securities	–	28.7	1,917.3	2,957.1	–	–	4,903.1
Derivative financial instruments	67.0	689.8	–	–	–	218.8	975.6
Equity shares	–	–	–	7.2	–	–	7.2
Amounts owed by other Co-operative Group undertakings	–	–	0.6	–	–	–	0.6
Total financial assets	67.0	792.6	41,117.6	2,964.3	–	218.8	45,160.3
Non-financial assets							421.0
Total assets							45,581.3
Liabilities							
Deposits by banks	–	–	–	–	2,938.6	–	2,938.6
Customer accounts	–	–	–	–	32,320.0	–	32,320.0
Customer accounts – capital bonds	–	1,794.7	–	–	–	–	1,794.7
Debt securities in issue	–	–	–	–	4,212.2	–	4,212.2
Derivative financial instruments	52.9	487.6	–	–	–	161.9	702.4
Other borrowed funds	–	–	–	–	975.4	–	975.4
Amounts owed to other Co-operative Group undertakings	–	–	–	–	188.5	–	188.5
Total financial liabilities	52.9	2,282.3	–	–	40,634.7	161.9	43,131.8
Non-financial liabilities							376.4
Total liabilities							43,508.2
Capital and reserves							2,073.1
Total liabilities and equity							45,581.3

39. Fair values of financial assets and liabilities continued

Balance sheet categories	Held for trading	Designated at fair value	Loans and receivables	Available for sale	Liabilities at amortised cost	Cashflow hedges	Total
2011							
Bank							
Assets							
Cash and balances at central banks	–	–	6,696.6	–	–	–	6,696.6
Loans and advances to banks	–	–	1,300.1	–	–	–	1,300.1
Loans and advances to customers	–	114.1	22,986.7	–	–	–	23,100.8
Investment securities	–	343.1	866.1	3,107.4	–	–	4,316.6
Derivative financial instruments	166.4	319.5	–	–	–	218.5	704.4
Equity shares	–	–	–	5.7	–	–	5.7
Amounts owed by other Co-operative Group undertakings	–	–	12,961.2	–	–	–	12,961.2
Total financial assets	166.4	776.7	44,810.7	3,113.1	–	218.5	49,085.4
Non-financial assets							1,880.3
Total assets							50,965.7
Liabilities							
Deposits by banks	–	–	–	–	3,239.8	–	3,239.8
Customer accounts	–	–	–	–	32,670.1	–	32,670.1
Customer accounts – capital bonds	–	1,397.3	–	–	–	–	1,397.3
Debt securities in issue	–	–	–	–	1,431.0	–	1,431.0
Derivative financial instruments	146.0	799.3	–	–	–	106.2	1,051.5
Other borrowed funds	–	–	–	–	1,258.8	–	1,258.8
Amounts owed to other Co-operative Group undertakings	–	4,525.7	–	–	2,935.5	–	7,461.2
Total financial liabilities	146.0	6,722.3	–	–	41,535.2	106.2	48,509.7
Non-financial liabilities							295.6
Total liabilities							48,805.3
Capital and reserves							2,160.4
Total liabilities and equity							50,965.7

Notes to the financial statements continued

For the year ended 31 December 2011

All amounts are stated in £m unless otherwise indicated

39. Fair values of financial assets and liabilities continued

Balance sheet categories	Held for trading	Designated at fair value	Loans and receivables	Available for sale	Liabilities at amortised cost	Cashflow hedges	Total
2010							
Bank							
Assets							
Cash and balances at central banks	–	–	1,735.6	–	–	–	1,735.6
Loans and advances to banks	–	–	1,728.6	–	–	–	1,728.6
Loans and advances to customers	–	74.1	23,935.4	–	–	–	24,009.5
Investment securities	–	28.7	1,986.8	2,621.4	–	–	4,636.9
Derivative financial instruments	70.4	415.5	–	–	–	218.8	704.7
Equity shares	–	–	–	7.2	–	–	7.2
Amounts owed by other Co-operative Group undertakings	–	–	14,233.7	–	–	–	14,233.7
Total financial assets	70.4	518.3	43,620.1	2,628.6	–	218.8	47,056.2
Non-financial assets							1,758.7
Total assets							48,814.9
Liabilities							
Deposits by banks	–	–	–	–	2,870.8	–	2,870.8
Customer accounts	–	–	–	–	29,912.0	–	29,912.0
Customer accounts – capital bonds	–	1,744.0	–	–	–	–	1,744.0
Debt securities in issue	–	–	–	–	1,856.8	–	1,856.8
Derivative financial instruments	56.3	479.2	–	–	–	161.9	697.4
Other borrowed funds	–	–	–	–	975.4	–	975.4
Amounts owed to other Co-operative Group undertakings	–	5,848.7	–	–	2,492.2	–	8,340.9
Total financial liabilities	56.3	8,071.9	–	–	38,107.2	161.9	46,397.3
Non-financial liabilities							314.1
Total liabilities							46,711.4
Capital and reserves							2,103.5
Total liabilities and equity							48,814.9

a. Use of financial instruments

The use of financial instruments is essential to the Bank's business activities, and financial instruments constitute a significant proportion of the Bank's assets and liabilities. The main financial instruments used by the Group, and the purposes for which they are held, are outlined below.

Loans and advances to customers and customer accounts

The provision of banking facilities to customers is the prime activity of the Bank, and loans and advances to customers and customer accounts are major constituents of the balance sheet. Loans and advances to customers include retail mortgages, corporate loans, credit cards, unsecured retail lending and overdrafts. Customer accounts include retail and corporate current and savings accounts. The Bank has detailed policies and procedures to manage risks. Retail mortgage lending and much of the lending to corporate and business banking customers is secured.

Loans and advances to banks and investment securities

Loans and advances to banks and investment securities underpin the Bank's liquidity requirements and generate incremental net interest and trading income.

Deposits by banks and debt securities in issue

The Bank issues medium term notes within an established euro medium term note programme and also issues certificates of deposit and commercial paper as part of its normal treasury activities. 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.

Other borrowed funds

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, when appropriate, the Bank issues preference shares and perpetual and fixed term subordinated notes.

39. Fair values of financial assets and liabilities continued

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.

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.

b. Valuation of financial instruments carried at fair value

The following tables analyse financial assets and liabilities carried at fair value by the three level fair value hierarchy as defined within IFRS 7 (Financial Instruments: Disclosure):

- Level 1 – Quoted market prices in active markets
- Level 2 – Valuation techniques using observable inputs
- Level 3 – Valuation techniques using unobservable inputs

	Fair value at end of the reporting period using:			
	Level 1	**Level 2**	**Level 3**	**Total**
2011				
Group				
Non-derivative financial assets				
Designated at fair value				
Loans and advances to customers	**–**	**101.7**	**12.4**	**114.1**
Investment securities	**343.1**	**–**	**–**	**343.1**
Available for sale financial assets				
Investment securities	**1,836.9**	**1,586.1**	**–**	**3,423.0**
Equity shares	**–**	**–**	**5.7**	**5.7**
Derivative financial instruments	**–**	**950.4**	**25.4**	**975.8**
Total assets carried at fair value	**2,180.0**	**2,638.2**	**43.5**	**4,861.7**
Non-derivative financial liabilities				
Designated at fair value				
Customer accounts – capital bonds	**–**	**1,429.8**	**–**	**1,429.8**
Derivative financial instruments	**–**	**1,074.6**	**13.3**	**1,087.9**
Total liabilities carried at fair value	**–**	**2,504.4**	**13.3**	**2,517.7**

	Fair value at end of the reporting period using:			
	Level 1	Level 2	Level 3	Total
2010				
Group				
Non-derivative financial assets				
Designated at fair value				
Loans and advances to customers	–	62.3	11.8	74.1
Investment securities	–	28.7	–	28.7
Available for sale financial assets				
Investment securities	902.9	2,054.2	–	2,957.1
Equity shares	–	–	7.2	7.2
Derivative financial instruments	–	958.1	17.5	975.6
Total assets carried at fair value	902.9	3,103.3	36.5	4,042.7
Non-derivative financial liabilities				
Designated at fair value				
Customer accounts – capital bonds	–	1,794.7	–	1,794.7
Derivative financial instruments	–	675.2	27.2	702.4
Total liabilities carried at fair value	–	2,469.9	27.2	2,497.1

Notes to the financial statements continued
For the year ended 31 December 2011
All amounts are stated in £m unless otherwise indicated

39. Fair values of financial assets and liabilities continued

	Fair value at end of the reporting period using:			
	Level 1	**Level 2**	**Level 3**	**Total**
2011				
Bank				
Non-derivative financial assets				
Designated at fair value				
Loans and advances to customers	**–**	**101.7**	**12.4**	**114.1**
Investment securities	**343.1**	**–**	**–**	**343.1**
Available for sale financial assets				
Investment securities	**1,836.9**	**1,270.5**	**–**	**3,107.4**
Equity shares	**–**	**–**	**5.7**	**5.7**
Derivative financial instruments	**–**	**694.9**	**9.5**	**704.4**
Total assets carried at fair value	**2,180.0**	**2,067.1**	**27.6**	**4,274.7**
Non-derivative financial liabilities				
Designated at fair value				
Customer accounts – capital bonds	**–**	**1,397.3**	**–**	**1,397.3**
Amounts owed to other Co-operative Group undertakings	**–**	**–**	**4,525.7**	**4,525.7**
Derivative financial instruments	**–**	**1,041.6**	**9.9**	**1,051.5**
Total liabilities carried at fair value	**–**	**2,438.9**	**4,535.6**	**6,974.5**

	Fair value at end of the reporting period using:			
	Level 1	Level 2	Level 3	Total
2010				
Bank				
Non-derivative financial assets				
Designated at fair value				
Loans and advances to customers	–	62.3	11.8	74.1
Investment securities	–	28.7	–	28.7
Available for sale financial assets				
Investment securities	902.9	1,718.5	–	2,621.4
Equity shares	–	–	7.2	7.2
Derivative financial instruments	–	684.6	20.1	704.7
Total assets carried at fair value	902.9	2,494.1	39.1	3,436.1
Non-derivative financial liabilities				
Designated at fair value				
Customer accounts – capital bonds	–	1,744.0	–	1,744.0
Amounts owed to other Co-operative Group undertakings	–	–	5,848.7	5,848.7
Derivative financial instruments	–	679.9	17.5	697.4
Total liabilities carried at fair value	–	2,423.9	5,866.2	8,290.1

Certain derivative financial instruments in Group and Bank have been reclassified between level 2 and level 3 in 2010 following a reassessment of the inputs used in the valuation models.

The carrying values of financial instruments measured at fair value are determined in compliance with the accounting policies on pages 37 to 45 and according to the following hierarchy:

Level 1 – Quoted market prices in active markets
Financial instruments with quoted prices for identical instruments in active markets. The best evidence of fair value is a quoted market price in an actively traded market.

Level 2 – Valuation techniques using observable inputs
Financial instruments with quoted prices for similar instruments in active markets or quoted prices for identical or similar instruments in inactive markets and financial instruments valued using models where all significant inputs are observable.

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

39. Fair values of financial assets and liabilities continued

Loans and advances to customers
Loans and advances to customers include corporate loans of £101.7m (2010: £62.3m) which are fair valued through income or expense using observable inputs. Loans held at fair value are valued at the sum of all future expected cash flows, discounted using a yield curve based on observable market inputs.

Investment securities – available for sale
Fair value is based on available market prices. Where this information is not available, fair value has been estimated using quoted market prices for securities with similar credit, maturity and yield characteristics.

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

During 2011 the Group moved to using Overnight Indexed Swap (OIS) rates to value cash collateralised swaps, resulting in a one off charge to the income statement of £6m.

Customer accounts – capital bonds
The estimated fair value of customer accounts – capital bonds is based on independent third party valuations using forecast future movements in the appropriate indices.

Level 3 – Valuation techniques using unobservable inputs
This is used for financial instruments valued using models where one or more significant inputs are not observable.

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

Loans and advances to customers
Loans and advances to customers include 25 year fixed rate mortgages of £12.4m (2010: £11.8m) which are fair valued through income or expense using unobservable inputs. These mortgages are valued using future interest cash flows at the fixed customer rate and estimated schedule of customer repayments. Cash flows are discounted at a credit adjusted discount rate; the credit adjustment is based on the average margin of new long dated (five years or greater) fixed rate business written in the last six months, and subject to quarterly review. The eventual timing of future cash flows may be different from that forecast due to unpredictable customer behaviour, particularly on a 25 year product. The valuation methodology takes account of credit risk and has decreased the valuation by £0.5m in 2011 (2010: £0.1m). A reasonable change in the assumptions would not result in any material change in the valuation.

Equity shares
Equity shares primarily relate to investments held in Vocalink Limited which are unquoted shares. The valuation of these shares is based on the Group's percentage shareholding and the net asset value of the company according to its most recently published financial statements.

Amounts owed to other Co-operative Group undertakings
Deposits from customers includes deposits by Moorland Covered Bond LLP (the LLP), Silk Road Finance Number One plc (Silk Rd 1) and Silk Road Finance Number Two plc (Silk Rd 2) subsidiaries relating to the legal transfer of loans and advances on issue of the Bank's covered bonds and securitisations. The deposits are fair valued to eliminate an accounting mismatch of the swap derivative as discussed below.

Revaluation of the £4.5bn (2010: £5.9bn) mortgage pool from carrying to fair value is based on assumed timing of future mortgage capital and revenue receipts, discounted to present value using a credit adjusted discount rate.

The amortisation profile is as per the swap's 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 the end of any offer period.

Derivative financial instruments
Derivative financial instruments including internal interest rate swaps have been entered into between the Bank and the LLP, the Bank and Silk Rd 1 and the Bank and Silk Rd 2.

The purpose of the swap is to convert the fixed and base rate linked revenue receipts of the pool of mortgage assets to the same LIBOR linked basis as the intercompany loan. Under this swap arrangement the LLP or Silk Rd 1 or Silk Rd 2 pays to the swap counterparty the monthly mortgage revenue receipts of the pool of assets and receives from the swap counterparty LIBOR plus a contractual spread on the same notional balance; the spread being sufficient to cover the intercompany loan and any expenses.

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

The fair value of the swap is based on a valuation model that reflects the mortgage cash flows over a three year period using a discount rate based on LIBOR spreads. This derivative eliminates on consolidation.

Notes to the financial statements continued
For the year ended 31 December 2011
All amounts are stated in £m unless otherwise indicated

39. Fair values of financial assets and liabilities continued
Movements in fair values of instruments with significant unobservable inputs (level 3) were:

	Fair value at the beginning of the year	Purchases	Sales	Income or expense including impairment	Fair value at the end of the year
2011					
Group					
Loans and advances to customers	**11.8**	**–**	**–**	**0.6**	**12.4**
Derivative assets	**17.5**	**–**	**–**	**7.9**	**25.4**
Equity shares	**7.2**	**–**	**–**	**(1.5)**	**5.7**
Derivative liabilities	**(27.2)**	**–**	**–**	**13.9**	**(13.3)**
	9.3	**–**	**–**	**20.9**	**30.2**
2010					
Group					
Loans and advances to customers	11.8	–	–	–	11.8
Derivative assets	–	–	–	17.5	17.5
Equity shares	7.2	–	–	–	7.2
Derivative liabilities	–	–	–	(27.2)	(27.2)
	19.0	–	–	(9.7)	9.3

	Fair value at the beginning of the year	Purchases	Sales	Income or expense including impairment	Fair value at the end of the year
2011					
Bank					
Loans and advances to customers	**11.8**	**–**	**–**	**0.6**	**12.4**
Derivative assets	**20.1**	**–**	**–**	**(10.6)**	**9.5**
Equity shares	**7.2**	**–**	**–**	**(1.5)**	**5.7**
Derivative liabilities	**(17.5)**	**–**	**–**	**7.6**	**(9.9)**
Amounts owed to other Co-operative Group undertakings	**(5,848.7)**	**(833.1)**	**2,145.3**	**10.8**	**(4,525.7)**
	(5,827.1)	**(833.1)**	**2,145.3**	**6.9**	**(4,508.0)**
2010					
Bank					
Loans and advances to customers	11.8	–	–	–	11.8
Derivative assets	39.2	–	–	(19.1)	20.1
Equity shares	7.2	–	–	–	7.2
Derivative liabilities	–	–	–	(17.5)	(17.5)
Amounts owed to other Co-operative Group undertakings	(3,397.6)	(3,076.2)	625.1	–	(5,848.7)
	(3,339.4)	(3,076.2)	625.1	(36.6)	(5,827.1)

39. Fair values of financial assets and liabilities continued

c. Fair values of financial instruments not carried at fair value

The carrying values of financial instruments measured at amortised cost are determined in compliance with the accounting policies on pages 37 to 45.

The table below sets out a summary of the carrying and fair values of:

- financial assets classified as loans and receivables; and
- financial liabilities classified as held at amortised cost,

unless there is no significant difference between carrying and fair values.

	Group		Bank	
	Carrying value	**Fair value**	**Carrying value**	**Fair value**
2011				
Financial assets				
Loans and receivables				
Loans and advances to banks	**2,006.5**	**2,004.2**	**1,300.1**	**1,297.8**
Loans and advances to customers	**34,018.2**	**34,236.4**	**22,986.7**	**22,988.4**
Investment securities	**804.9**	**798.5**	**866.1**	**859.7**
Financial liabilities				
Financial liabilities at amortised cost				
Deposits by banks	**3,302.7**	**3,305.1**	**3,239.8**	**3,242.2**
Customer accounts	**34,990.6**	**35,138.9**	**32,670.1**	**32,812.2**
Debt securities in issue	**4,164.8**	**4,008.1**	**1,431.0**	**1,434.5**
Other borrowed funds	**1,258.8**	**1,092.6**	**1,258.8**	**1,092.6**

	Group		Bank	
	Carrying value	Fair value	Carrying value	Fair value
2010				
Financial assets				
Loans and receivables				
Loans and advances to banks	2,394.1	2,391.8	1,728.6	1,726.3
Loans and advances to customers	35,070.0	35,696.9	23,935.4	24,436.0
Investment securities	1,917.3	2,036.4	1,986.8	2,119.6
Financial liabilities				
Financial liabilities at amortised cost				
Deposits by banks	2,938.6	2,971.1	2,870.8	2,903.3
Customer accounts	32,320.0	32,400.8	29,912.0	29,985.7
Debt securities in issue	4,212.2	4,831.7	1,856.8	1,898.6
Other borrowed funds	975.4	1,107.4	975.4	1,107.4

Key considerations in the calculation of fair values for loans and receivables and financial liabilities at amortised cost are as follows:

Loans and advances to banks/deposits by banks

Loans and advances to banks include interbank placements and items in the course of collection.

The 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.

Notes to the financial statements continued

For the year ended 31 December 2011

All amounts are stated in £m unless otherwise indicated

39. Fair values of financial assets and liabilities continued

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 historical behavioural experience where relevant. The eventual timing of future cash flows may be different from the forecast due to unpredictable customer behaviour. It is assumed 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.

Investment securities

Fair value is based on available market prices. Where this information is not available, fair value has been estimated using quoted market prices for securities with similar credit, maturity and yield characteristics.

Customer accounts

The estimated fair value of deposits with no stated maturity, which includes non-interest bearing deposits, is the amount repayable on demand. The estimated fair value of fixed interest bearing deposits and other borrowings without quoted market prices is based on discounted cash flows using interest rates for new debts with similar remaining maturity.

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 cashflow model is used based on a current yield curve appropriate for the remaining term to maturity.

Responsibility statement
For the year ended 31 December 2011

We confirm that to the best of our knowledge:

- the financial statements, prepared in accordance with the applicable set of accounting standards, give a true and fair view of the assets, liabilities, financial position and profit or loss of the Company and the undertakings included in the consolidation taken as a whole; and
- the directors' report includes a fair review of the development and performance of the business and the position of the issuer and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties that they face.

By Order of the Board
Barry Tootell, Acting Chief Executive

28 March 2012

Notice of Annual General Meeting 2012

NOTICE IS HEREBY GIVEN that the Annual General Meeting of The Co-operative Bank plc will be held on the 24th Floor, CIS Building, Miller Street, Manchester, M60 0AL at 10am on Wednesday, 16 May 2012 for the following purposes:

Ordinary Business

1. To receive the notice convening the meeting.
2. To receive the annual reports and adopt the financial statements for the year ended 31 December 2011, together with the auditor's report.
3. To approve the remuneration report for the year ended 31 December 2011.
4. To accept the following recommendations of the Board in respect of the non-cumulative irredeemable preference shares:
   (i) that the payment of the dividend of 4.625p per £1 share on 30 November 2011 be confirmed.
   (ii) that a dividend of 4.625p per £1 share be declared and paid on 31 May 2012 to the registered holders as at 3 May 2012 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 Articles 105 and 105A:
   (i) Paul Flowers, non-executive director (Chair)
   (ii) Peter Marks, non-executive director
   (iii) Paul Hewitt, 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) Anne Gunther, non-executive director
   (ii) Merlyn Lowther, non-executive director
7. To re-appoint KPMG Audit Plc as auditor of the Company, to hold office from the conclusion of this meeting until the conclusion of the next Annual General Meeting at which accounts are laid before the Company, at a remuneration to be fixed by the directors.

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Reg. No. 990937 (England)
Tel: 0161 832 3456
Fax: 0161 829 4475
Tel: 0870 702 0003

Registrar
Computershare Investor Services PLC
PO Box 82
The Pavilions
Bridgwater Road
Bristol BS99 7NH

By Order of the Board
Moira Lees, Secretary

28 March 2012

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 9am on 14 May 2012. This applies to shares held in uncertified forms in CREST and to shares held in certified form.

Notes:

1. **Director Information**
   The biographies of the directors up for re-election and re-appointment at the Annual General Meeting can be found on page 10 of the 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.

Glossary

For the year ended 31 December 2011

The following glossary defines terminology used within the Group's Financial Statements to assist the reader and to facilitate comparison with publications by other financial institutions:

Terminology	Definition
Almost prime	Almost prime lending is lending to borrowers with very low levels of adverse credit history.
Arrears	Customers are said to be in arrears or non-performing when they are behind in fulfilling their obligations with the result that an outstanding loan is unpaid or overdue. Corporate customers may also be considered non-performing prior to being behind in fulfilling their obligations. This can happen when a significant restructuring exercise begins.
Asset & Liability Committees (ALCO)	These committees are management committees of the Board which are chaired by the Chief Financial Officer. 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.
Audit Committee (AC)	The committee which provides oversight in relation to financial reporting, internal control, regulatory compliance, external and internal audit across the Banking Group.
Automated Valuation Model (AVM)	A valuation model used specifically for low loan to value (LTV) remortgages. Performance of AVMs is monitored on a regular basis to ensure their ongoing accuracy.
Bank for International Settlements (BIS)	An international organisation which fosters international monetary and financial co-operation and serves as a bank for central banks. Based in Basel, Switzerland.
Basel II	A statement of best practice issued by the Basel Committee on Banking Supervision, that defines the methods by which firms should calculate their regulatory capital requirements to retain enough capital to protect the financial system against unexpected losses. Basel II became law in the EU Capital Requirements Directive, and was implemented in the UK via the FSA Handbook.
Basel III	A strengthening of the requirements laid out in Basel II, to be phased into the Bank gradually between 2013 and 2019 ahead of full implementation by 2023.
Basis points (bps)	One hundredth of a per cent (0.01%), so 100 basis points is 1%. Used in quoting movements in interest rates or yields on securities.
BIPRU	The prudential sourcebook for banks, building societies and investment firms which sets out the FSA's capital requirements.
Britannia membership reward (BMR)	This was designed to reward customers for the contribution they made to the continued success of Britannia's business. After an initial qualifying period, certain customers of Britannia were able to earn points each year. Each year, the Board decided the amount to be paid out as the reward pool, and distributed this to the customers in proportion to the number of points earned.
Business model and external risk	Risk arising from changes to the Bank's business and the environment in which it operates, specifically the risk of not being able to carry out the Bank's business plan and desired strategy.
Buy to let	A commercial practice of buying a property to let to tenants, rather than to live in.
Capital bonds	Fixed term customer accounts with returns based on the movement in an index (eg FTSE 100) over the term of the bond.
Capital ratio	Total of tier one capital plus tier two capital, all divided by risk weighted assets.
Capital Requirements Directive (CRD)	The common framework for the implementation of Basel II in the EU.
Carrying value	The value of an asset or liability as it appears in the balance sheet. For each asset or liability, the value is based on either of the amortised cost or fair value principles.
Certificates of deposit (CDs)	Debt issued by banks, savings and loan associations to individual investors with terms ranging from a few months to several years. Longer term CDs tend to bear a higher interest rate. At the expiration of the term, investors may (subject to penalties) withdraw both the principal and the accrued interest.
Charged off	When all economical avenues to recover an unsecured debt have been exhausted, the Bank permanently closes the loan account, ie it is charged off. This final step sits at the end of a time frame within which the Bank attempts to manage the debt's recovery and differs from a 'write down' in terms of its fixed position in time (see 'Write down').
Collateral	A borrower's pledge, usually a property, which acts as security for repayment of the loan (see 'Secured lending').
Collateralised swap	A swap, whose volatility is secured (collateralised) by way of exchanging cash deposits (see 'Swaps').
Colleague engagement	An internal survey, measuring the level of the Bank's employees' engagement.
Collectively assessed for impairment	Impairment is measured collectively where a portfolio comprises assets with a homogenous risk and where appropriate statistical techniques are available.
Commercial Paper	An unsecured promissory note issued to finance short term credit needs. It specifies the face amount paid to investors on the maturity date.

Glossary continued
For the year ended 31 December 2011

Terminology	**Definition**
Contagion risk	An international financial market term which describes a corrupting or harmful influence, spreading effects of shocks from one counterparty to another.
Corporate and Business Banking (CABB)	The Group's operating segment which includes Corporate, Optimum and Platform. This includes lending to large corporate and commercial entities, acquired mortgage books and a specialist mortgage team dealing with intermediary lending.
Cost to income ratio	Operating expenses compared with operating income.
Council of Mortgage Lenders (CML)	A financial services industry body representing mortgage lenders in the United Kingdom.
Counterparty	In any financial contract, the person or institution entering the contract on the opposite side of the transaction is called a counterparty.
Covered bonds	Debt securities backed by a portfolio of mortgages that are segregated from the issuer's other assets solely for the benefit of the holders of the covered bonds. The Bank issues covered bonds as part of its funding activities.
Credit Committee	A committee, chaired by the Banking Risk Officer, which has delegated authority for approving credit facilities within approved strategies and delegated authorities.
Credit conversion factors	The portion of an off balance sheet commitment drawn in the event of a future default. The conversion factor is expressed as a percentage. The conversion factor is used to calculate the exposure at default (EAD).
Credit default swap	An arrangement whereby the credit risk of an asset (the reference asset) is transferred from the buyer to the seller of protection. A credit default swap is a contract where the protection seller receives premium or interest related payments in return for contracting to make payments to the protection buyer upon a defined credit event. Credit events normally include bankruptcy, payment default on a reference asset or assets, or downgrades by a credit rating agency.
Credit risk	The current or prospective risk to earnings and capital arising from a borrower's failure to meet the terms of any contract with the Bank or its failure to perform as agreed.
Credit Risk Control Unit (CRCU)	This function provides an independent view of credit risk in order to support the business management functions' decision making. CRCU does not directly benefit from decisions to extend credit. The CRCU provides risk oversight by virtue of its independence from the business management functions. The CRCU function is in house and is not outsourced.
Customer advocacy	An external survey, measuring the level of the Bank's customers who would personally recommend the Bank to other potential new customers as their primary financial services provider.
Customer deposits	Money deposited by all individuals and companies that are not credit institutions. Such funds are recorded as liabilities in the Bank's balance sheet under customer accounts or financial liabilities designated at fair value.
Customer funding ratio	The ratio of customer loans funded by customer deposits. This is the reverse equation of the customer loan to deposit ratio (see 'Customer loan to deposit ratio').
Customer loan to deposit ratio	Customer loans divided by customer deposits. This is the reverse equation of the customer funding ratio (see 'Customer funding ratio').
Debt for equity swaps	The act whereby a creditor exchanges a loan asset for a stake in its relevant debtor company's equity share capital.
Delinquency	A customer in arrears is also said to be in a state of delinquency. When a customer is in arrears, his entire outstanding balance is said to be delinquent, meaning that delinquent balances are the total outstanding loans on which payments are overdue (see 'Arrears').
Derivative	A financial instrument that has a value, based on the expected future price movements of the instrument to which it is linked, such as a share or a currency.
Effective interest rate method (EIR)	The method used to measure the carrying value of certain financial assets or liabilities and to allocate associated interest income or expense over the relevant period.
Eurozone	The geographical area containing countries whose economies function using the European single currency.
Executive Team	The team which manages the business in line with the Board risk appetite statement. It also maintains oversight of risk management processes and management information.
Expected charge off rate	The expected level of a portfolio's loans that may be written off as bad debt.
Expected loss	A measure of anticipated loss for exposures captured under an internal ratings based credit risk approach. The expected loss amount is the exposure from a potential default of a counterparty or dilution over a one year period to the amount outstanding at default.
Exposure at default (EAD)	A Basel II parameter used in internal ratings based approaches to estimate the amount outstanding at the time of default.
Exposures Committee	The committee which monitors and controls the Banking Group's major credit exposures. Decision making responsibilities include the sanctioning of large counterparty transactions.
External audit	The independent review of the financial statements of the company, by an external firm.

Terminology	Definition
External credit rating	A financial indicator of risk, assigned by credit rating agencies, to potential investors in the Group.
Fair value adjustments	Fair value adjustments are the remaining balance sheet adjustments for the assets/liabilities acquired on the merger of the Bank and Britannia Building Society on 1 August 2009.
Fair value amortisation	The amortisation of the remaining interest risk related, fair value adjustments for the assets/liabilities acquired on the merger of the Bank and Britannia Building Society on 1 August 2009 (see 'Interest rate risk').
Financial instruments	Any document with monetary value. Examples include cash and cash equivalents, but also securities such as bonds and stocks which have value and may be traded in exchange for money.
Financial Services Authority (FSA)	An independent non-governmental body, given statutory powers by the Financial Services and Markets Act 2000, which regulates the financial services industry in the best interests of its stakeholders. It is a company limited by guarantee and financed by the financial services industry.
Financial Services Compensation Scheme (FSCS)	The UK's compensation fund of last resort for customers of authorised financial services firms. The FSCS may pay compensation to customers if a firm is unable, or likely to be unable, to pay claims against it, usually because it has stopped trading or has been declared in default. The FSCS is funded by the financial services industry. Every firm authorised by the FSA is obliged to pay an annual levy, which goes towards its running costs and compensation payments.
Floating rate notes (FRNs)	Investments with a variable interest rate. The adjustments to the interest rate are usually made every six months and are tied (or 'float') to a certain money market index.
Forbearance	The act of preventing a secured loan's counterparty from defaulting by relaxing and/or changing the borrower's repayment terms.
Foreclosure	The legal process by which a lender, eg the Bank, obtains a court order in order to terminate a borrower's equitable right of redemption. This legal action is required when a borrower has materially failed to comply with the agreed terms and conditions of the loan, eg by defaulting (see 'Forbearance').
Forward rate agreement	A legal contract, governing the terms and conditions of a forward or future, in which the buyer pays a fixed rate of interest to the seller in return for the seller's floating rate (see 'Forwards', 'Futures' and 'Swaps').
Forwards	Non-standardised contracts, traded over the counter, between two parties to buy or sell financial instruments at a specified future time at a price agreed today (see 'Over The Counter').
Futures	Standardised contracts, traded on an exchange, between two parties to buy or sell financial instruments at a specified future time at a price agreed today.
Gap	The Bank's net exposure to variable elements being managed within its market risk, eg interest rate movements (see 'Market risk').
Hedging	A technique used by the Bank to offset risks on one instrument by purchasing a second instrument that is expected to perform in the opposite way.
Her Majesty's Treasury (HMT)	Informally The Treasury, is the United Kingdom government department responsible for developing and executing the government's public finance policy and economic policy.
Impaired loans	Loans where the Bank does not expect to collect all the contractual cash flows or expects to collect them later than they are contractually due.
Individual Liquidity Adequacy Assessment (ILAA)	The Bank's assessment of its liquidity risks, controls and quantification of liquid assets required to survive severe financial shocks through the use of stress tests prescribed by the FSA (see 'Liquidity risk').
Individual Liquidity Guidance (ILG)	A FSA guidance on the required amount and composition of the liquid assets buffer that should be held by a firm. This guidance arises once the firm's Individual Liquidity Adequacy Assessment (ILAA) has been conducted.
Individually assessed for impairment	Impairment is measured individually for assets that are individually significant.
Institute of International Finance (IIF)	A global association of financial institutions which provides industry guidelines on areas such as liquidity management.
Interest rate risk	The variability in value borne by an interest bearing asset, such as a loan or a bond, due to variability of interest rates. In general, as rates rise, the price of a fixed rate bond will fall, and vice versa.
Internal audit	The examination of the company's records and reports by its employees. Internal audits are usually intended to prevent fraud and to ensure compliance with Board directives and management policies.
Internal Capital Adequacy Assessment Process (ICAAP)	The Bank's own assessment, as part of Basel II requirements, of the levels of capital that it needs to hold in respect of its regulatory capital requirements (for credit, market and operational risks) and for other risks including stress events.
Internal rating grade (IRG)	The grading of credit risk resulting from the internal ratings based approach (IRB).
Internal ratings based approach (IRB)	A Basel II approach for measuring exposure to credit risks. IRB approaches are more sophisticated and risk sensitive than the Standardised Approach and may be Foundation or Advanced. IRB approaches may only be used with FSA permission.
Investment grade	A debt security, treasury bill or similar instrument with a credit rating measured by external agencies of AAA to BBB.

Glossary continued
For the year ended 31 December 2011

Terminology	Definition
LIBOR (London Interbank Offered Rate)	The interest rate participating banks offer to other banks for loans on the London market.
Lifetime expected loss	The losses that the Bank expects to incur over the lifetime of portfolios of mortgage assets which were acquired on merger with Britannia Building Society. This is different from expected loss (see 'Expected loss') which is based on assets expected to default in the next 12 months.
Limited Liability Partnership (LLP)	An LLP provides each of its individual partners protection against personal liability for certain partnership liabilities.
Liquidity risk	The risk that the Bank's resources will prove inadequate to meet its commitments. It arises from the timing of cash flows generated from the Group's assets and liabilities (including derivatives).
Loan to value (LTV)	A ratio which expresses the amount of a mortgage as a percentage of the value of the property. The Bank calculates residential mortgage LTV on an indexed basis (the value of the property is updated on a quarterly basis to reflect changes in the house price index (HPI)).
Loss provisions	Provisions held against assets on the balance sheet as a result of the raising of a charge against profit for the incurred loss inherent in the lending book. The allowance represents management's best estimate of losses incurred in the loan portfolio at the balance sheet date.
Low risk	Within neither past due nor impaired, low risk has been defined as exposures where the probability of deficit (PD) is 1% or below over a one year time horizon for exposures on an internal ratings based (IRB) approach under Basel II, and slotting category strong/good/satisfactory for specialised lending exposures under the slotting approach (see 'Slotting').
Lower tier two	Lower tier two capital comprises the Bank's long term subordinated debt.
Malus	A facility whereby the Remuneration Committee may reduce the amount of any deferred bonus payable in the event that any of the underpins to the incentive plans are not met or where business and/or individual performance otherwise requires.
Management expenses and compensation cost	The specific elements of both operating and financing cost which form the basis of the Financial Services Compensation Scheme (see 'Financial Services Compensation Scheme (FSCS)').
Mandatory reserve deposits	Mandatory reserve deposits are deposited with the Bank of England and are not available for use in the Group's day to day operations. They are non-interest bearing and are not included in cash and cash equivalents.
Market risk	The risk arising from the effect of changes in market prices of financial instruments, execution of customer and interbank business and proprietary trading. The majority of the Bank's market risk arises from changes in interest rates.
Medium term notes (MTN)	Flexible medium term corporate debt instruments, offered by the Bank to investors through a dealer. Investors can choose from differing maturities, ranging from nine months to 30 years.
Medium to high credit risk	Within neither past due nor impaired, medium to high risk has been defined as a probability of deficit (PD) of greater than 1% over a one year time horizon for exposure on internal ratings based (IRB) approach under Basel II, and slotting category weak for specialised lending exposures under the slotting approach (see 'Slotting').
Member	A person who has a share investment or a mortgage loan with the Bank.
Merger	Any combination of two or more business enterprises into a single enterprise. In the Group, this specifically refers to the merger of the Bank with Britannia Building Society on 1 August 2009 (see 'Transfer of engagements').
Mortgage backed securities	Securities that represent interests in a group of mortgages. Investors in these securities have the right to cash received from future interest and/or principal mortgage payments.
Multilateral Development Banks (MDBs)	Supranational institutions which provide financial support and professional advice for economic and social development activities in developing countries. The term MDBs typically refers to the World Bank Group and Regional Development Banks.
Net interest income	The difference between interest received on assets and interest paid on liabilities after taking into account the effect of derivatives.
Net present value (NPV)	The present value of the expected future cash in and out flows on an asset or liability.
Non-conforming	Loans originated by Platform prior to 2009 and those acquired by Britannia Treasury Services, with similar risk profiles to 'Almost prime' (see 'Almost prime').
Operational risk	The risk of loss resulting from inadequate or failed internal processes, people and systems or external events. This encompasses the effectiveness of risk management techniques and controls to minimise these losses.
Operational Risk Committee (ORC)	This committee reports into the Risk Management Group and is chaired by the Director of Specialist Risk Services. 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 Banking Group's business. Capital requirements in relation to operational risk are monitored by the RC.

Terminology	Definition
Optimum	A sub-segment within Corporate and Business Banking which includes acquired mortgage books and a specialist mortgage team dealing with intermediary lending.
Options	Instruments which convey the rights, but not the obligations, to engage in future transactions.
Over The Counter (OTC)	Contracts that are traded (and privately negotiated) directly between two parties, without going through an exchange or other intermediary. They offer flexibility because, unlike standardised exchange traded products, they can be tailored to fit specific needs.
Overnight Indexed Swap (OIS)	A rate reflecting the overnight interest typically earned or paid on the Bank's collateralised swaps. The OIS rate is used for valuing the discounted cash flows of collateralised swaps.
Past due	When a counterparty has failed to make a payment when contractually due.
Payments Hub	The Bank's proposal, as part of its transformation programme, to centralise payment mechanisms into a single model in order to maximise internal process efficiencies.
Portfolio Credit Committee (PCC)	A designated committee, reporting to the Risk Committee, that is responsible for defining the Banking Group's credit risk appetite; providing oversight and timely action in relation to credit risk management; monitoring, challenging and approving changes to Basel rating systems; and reviewing lending and arrears policies.
Preference shares	Preferred shares of the Group that are paid to a fixed non-cumulative preferential dividend. The dividends take priority over dividends to any other class of share in the capital of the Group.
Prime	Prime mortgages are mainstream residential loans, which typically have a higher credit quality and fit standard underwriting processes. As such, they are likely to have a good credit history and pass a standard affordability assessment at the point of origination.
Probability of default (PD)	The likelihood that a loan will not be repaid and will fall into default. PD may be calculated for each customer who has a loan (normally applicable to wholesale customers) or for a portfolio of customers with similar attributes (normally applicable to retail customers). To calculate PD, the Bank assesses the credit quality of borrowers and other counterparties and assigns them an internal risk rating.
Project Unity	The process enabling The Co-operative Group's combined family of companies to become fully integrated, delivering synergies, putting the customer at the heart of all that it does.
Re-age/Re-ages	A process whereby unsecured delinquent debt is moved to a less delinquent time band, upon the settlement of a percentage of the existing debt (see 'Delinquency').
Renegotiated loans	A permanent change to the terms and conditions of the customer's mortgage contract.
Repo/Reverse repo	A repurchase agreement that allows a borrower to use a financial security as collateral for a cash loan at a fixed rate of interest. In a repo, the borrower agrees to sell a security to the lender subject to a commitment to repurchase the asset at a specified price on a given date. For the party selling the security (and agreeing to repurchase it in the future) it is a repo; for the party on the other end of the transaction (buying the security and agreeing to sell in the future) it is a reverse repurchase agreement or reverse repo.
Retail segment	The segment that comprises customer focused products and services for individuals, sole traders and small partnerships. This includes mortgages, credit cards, consumer loans, current accounts and savings products.
Risk Committee (RC)	The committee responsible for the oversight, review and challenge of the adequacy of capital for all risks across the Banking Group.
Risk Management Group (RMG)	A designated committee, reporting to the Risk Committee, chaired by the Chief Risk Officer. Its purpose is to provide a mechanism to ensure that the Banking Group-wide risk management requirements, developments and processes are reviewed, challenged and approved (with escalation to RC where required) and embedded within and across the Banking Group. The committee also monitors all significant and emerging risks, and oversees the development and implementation of stress testing and risk appetite across the Banking Group.
Risk weighted amount	Risk weightings are established in accordance with Basel II as implemented by the FSA. Risk weighted amounts are the carrying value of the Bank's assets, adjusted by the risk weightings, to reflect the degrees of risk they represent.
Roll up mortgage	A mortgage, whose accrued interest is added to its principal amount and settled at the end of its repayment term.
Secured lending	Lending in which the borrower pledges retail or commercial property as collateral for the loan, which then becomes a secured debt owed to the Bank. In the event that the borrower defaults, the Bank may take possession of the asset used as collateral and may sell it to regain some or the entire amount originally lent to the borrower.
Securitisation	A process by which a portfolio of retail mortgages is used to back the issuance of new securities by an SPE. The Group has established securitisation structures as part of its funding and capital management activities (see 'Special purpose entities (SPEs)').
Significant items	Items which are material by both size and nature (ie outside of the normal operating activities of the Group) are treated as significant items and disclosed separately on the face of the income statement.

Glossary continued
For the year ended 31 December 2011

Terminology	**Definition**
Slotting	The regulatory defined approach used for rating the risk level of Corporate lending using a broad scope of financial, political and transactional factors. The regulatory slotting categories are listed as follows: – 'Unrated' businesses lack sufficient information upon which detailed credit analysis can be undertaken for which models have yet to be developed; – 'Strong' businesses have little competition, high demand, significant governmental support and enforceable collateral; – 'Good' businesses have limited competition, stable demand, good governmental support and enforceable collateral; – 'Satisfactory' businesses have a broad competition base with limited levels of demand, governmental support and collateral; – 'Weak' businesses operate at a disadvantage to competition, display a declining trend of demand, with no governmental support and no clear collateral; and – 'Default' businesses are considered unlikely to repay their credit obligations (see 'Impaired loans').
Sovereign exposure	The Bank's exposure to the total financial obligations incurred by all governmental bodies of any nation.
Special purpose entities (SPEs)	Entities that are created to accomplish a narrow and well defined objective. For the Bank this includes: – various securitisation transactions in which mortgages were sold to SPEs. The equity of these SPEs is not owned by the Bank. – Covered Bond Limited Liability Partnerships created in order to act as guarantors for issues of covered bonds.
Specialised lending	Lending in which the primary source of repayment of the obligation is the income generated by the assets being financed, rather than the independent capacity of a broader commercial enterprise.
Standard Variable Rate (SVR)	A variable and basic rate of interest charged on a mortgage. This may change in reaction to market conditions resulting in monthly repayments going up or down.
Subordinated debt/liabilities	Liabilities which, in the event of insolvency or liquidation of the Group, are subordinated to the claims of depositors and other creditors of the Group.
Swaps	An agreement between the Bank and a counterparty in which one stream of future payments is exchanged for another stream, based on a specified principal amount. For example, interest rate swaps often involve exchanging a fixed receipt for a floating receipt, which is linked to an interest rate (most often LIBOR). The Bank's use of swaps helps to manage periodic market risk on its financial instruments.
Technical risk	The (non-operational) risk and exposure to material loss of The Co-operative Banking Group being unable to meet its capital/liquidity/profit targets in line with approved risk appetite.
Tenor	The length of time until a loan is due. For example, a loan is taken out with a two year tenor. After one year passes, the tenor of the loan is one year.
Term deposit	A deposit balance that cannot be withdrawn before a date specified at the time of deposit.
the Bank	The Co-operative Bank as a standalone entity.
the Banking Group	See 'The Co-operative Banking Group'.
the Board	The Board of Directors. They manage the Banking Group's business performance in line with its purpose, givens, vision and values.
The Co-operative Banking Group	An internal brand, which is a consolidation of the following entities: CFS Management Services Ltd, CFS Services Ltd, CIS General Insurance Ltd, Co-operative Insurance Society Ltd, Co-operative Asset Management Ltd and Co-operative Bank plc.
The Co-operative Group	The ultimate holding company.
the Group	The Co-operative Bank consolidated with its subsidiaries.
Tier one	A regulatory measure of financial (capital) strength. Tier one is divided into core tier one and other tier one capital. Core tier one capital comprises general reserves from retained profits. The book values of goodwill and intangible assets are deducted from core tier one capital and other regulatory adjustments may be made for the purposes of capital adequacy. Qualifying capital instruments such as perpetual subordinated bonds are included in other tier one capital.
Tier one ratio	Tier one capital divided by risk weighted assets.
Tier two	Tier two capital comprises the Bank's property valuation reserve, preference shares, qualifying subordinated notes and collective impairment allowance (for exposures treated on a Basel II standardised basis). Certain regulatory deductions may be made for the purposes of assessing capital adequacy (see 'Upper tier two' and 'Lower tier two').
Transfer of engagements	On 1 August 2009, Britannia Building Society merged with The Co-operative Bank plc by a transfer of engagements between the building society and the bank under the Building Societies (Funding) and Mutual Societies (Transfers) Act 2007 (see 'Merger').
Transformation risk	The design, development and implementation risk associated with the Banking Group's significant change agenda that will transform the combined business into the 'compelling co-operative alternative'. This change is being managed in line with the Banking Group's risk appetite.

Terminology	**Definition**
Treasury segment	The treasury segment's responsibilities usually include capital management, risk management, strategic planning and investor relations.
Unencumbered	Those Bank assets which are not subject to any form of claim against them.
Unsecured lending	Lending for which there is no collateral for the loan.
Upper tier two	Upper tier two capital comprises the Group's preference shares, perpetual subordinated bonds and revaluation reserves.
Value at risk (VaR)	An estimate of the potential loss which might arise from market movements under normal market conditions, if the current positions were to be held unchanged for one business day, measured to a defined confidence level. The Bank uses a confidence level of 95%.
Watchlist	A list of counterparties, drawn up by the Bank once it has elected to closely monitor the performance of loans subject to significant credit risk.
Wholesale	Wholesale banking is the provision of loans to corporate customers and institutional customers and services to other banks and financial institutions.
Write down	After an advance has been identified as impaired and is subject to an impairment allowance, the stage may be reached whereby it is concluded that there is no realistic prospect of further recovery. Write downs will occur when, and to the extent that, the whole or part of a debt is considered irrecoverable. This action can occur at any time in the debt's life (see 'Charge off').

Notes

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