# The Co-operative Bank plc
Interim Financial Report 2015

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# Forward-looking statements

## Certain terms

The term the 'Bank' means The Co-operative Bank plc together with its consolidated subsidiaries.

In this report the abbreviations '£m' represent millions of pounds sterling.

Unless otherwise stated, the income statement analyses and compares the 6 months to 30 June 2015 to the corresponding 6 months of 2014. The balance sheet comprises the corresponding position as at 31 December 2014. Unless otherwise stated, all disclosed figures relate to continuing operations. Relevant terms that are used in this document but are not defined under applicable regulatory guidance or International Financial Reporting Standards (IFRS) are explained in non-IFRS measures below.

## Non-IFRS measures

Certain non-IFRS measures are provided within the Interim Financial Report. This can be found mainly (but not exclusively) on the Detailed financial review pages.

## Restatement

Furthermore, certain income statement items have been restated for the period to 30 June 2014. For further information, see note 3 to the Bank financial statements.

## Forward-looking statements

This document contains certain forward-looking statements with respect to certain of the Bank's strategy, plans and its current goals and expectations relating to its future financial condition and operating performance. The Bank cautions readers that no forward-looking statement is a guarantee of future performance and that actual results could differ materially from those contained in the forward-looking statements. These forward-looking statements can be identified by the fact that they do not relate only to historical or current facts. Forward-looking statements sometimes use words such as 'may', 'will', 'seek', 'continue', 'aim', 'anticipate', 'target', 'projected', 'expect', 'estimate', 'intend', 'plan', 'goal', 'believe', 'achieve', 'predict', 'should' or in each case, their negative or other variations or comparable terminology, or by discussion of strategy, plans, objectives, goals, future events or intentions. These forward-looking statements include all matters that are not historical facts. Examples of forward-looking statements include, among others, statements regarding the Bank's future financial position, income growth, assets, impairment charges, business strategy, capital ratios, leverage, payment of dividends, the industry in which the Bank operates, projected costs, commitments in connection with the Recapitalisation Plan and the Bank's 4-5 year turnaround plan, estimates of capital expenditures and plans and objectives for future operations and other statements that are not historical fact.

By their nature, forward-looking statements involve risk and uncertainty because they relate to events and depend on circumstances that may or may not occur in the future, for example, macroeconomic and business conditions, the effects of continued volatility in credit markets, market related risks such as changes in interest rates and foreign exchange rates, effects of changes in valuation of credit market exposures, changes in values of issued notes, the policies and actions of governmental and regulatory authorities (including requirements regarding capital and group structures and the potential for one or more countries exiting the Eurozone), changes in legislation, the further development of standards and of standards under IFRS, the outcome of current and future legal competition, a number of such factors being beyond the Bank's control. As a result, the Bank's actual future results may differ materially from the plans, goals and expectations set forth in the Bank's forward-looking statements. Forward-looking statements are not guarantees of future performance. In addition, even if the Bank's results of operations, financial condition, and the development of the financial services industry are consistent with the forward-looking statements in this document, those results or developments may not be indicative of results or developments in subsequent periods.

Readers are advised to read, in particular, the Principal risks and uncertainties section in this Interim Financial Report, as well as the 2014 Annual Report and Accounts and the Risk Factors document and prospectus published as part of the 2015 capital raising, both of which are available on our website (www.co-operativebank.co.uk) for a summary of factors that could affect the Bank's future performance. In light of these risks, uncertainties and assumptions, the events and targets described in the forward-looking statements in this document may not occur.

Any forward-looking statements made in this document speak only as of the date they are made except as required by the FCA, the PRA, the LSE or applicable law. The Bank expressly disclaims any obligation or undertaking to release publicly any updates or revisions to any forward-looking statements contained herein to reflect any change in the Bank's expectations with regard thereto or any change in events, conditions or circumstances on which such statement is based. The reader should, however, consult any additional disclosures that the Bank has made or may make in documents it has published or may publish via the Regulatory News Service of the LSE.

# Chairman's statement

**"The transformation required to rebuild The Co-operative Bank as a viable alternative to the traditional banks is not an easy task and we are very aware of the considerable challenges our colleagues have faced."**

The Co-operative Bank is a significantly stronger organisation than it was when the current management team joined the business in 2013 and, 18 months into our five year plan to turn the business around, we continue to make solid progress on our journey to a full recovery.

Under the leadership of our Chief Executive Officer, Niall Booker, we have further strengthened our overall capital resilience in this period. We completed the first significant tranche of our disposal of Optimum, a Non-core residential mortgage portfolio and we successfully raised £250m of Tier 2 capital despite a volatile market backdrop. Our transformation of the business into a simpler and more efficient retail bank is also progressing in line with our plan. Competitive pressures and a low interest rate environment continue to present challenges for the retail banking sector as a whole, but our performance is beginning to return to a more normalised position as we further invest in the brand and actively market our services to customers.

The investigations by the Financial Conduct Authority (FCA) and Prudential Regulation Authority (PRA) into what went wrong at the Bank are very important and the Board takes the terms of their recent notices and public censures extremely seriously. On behalf of the Bank, I would like to apologise again to customers for these past failings and reassure them that the Bank is a significantly stronger organisation today under the leadership of the current senior management team. The facts underlying the failings were largely set out in Sir Christopher Kelly's independent report published in April 2014, and, since then, the Bank has made material progress addressing these shortcomings by enhancing the Bank's governance, its processes, systems and practices. It has also significantly strengthened its Board and rebuilt its capital position. Nevertheless the Board is fully focused on continuing to remediate the findings of the investigation and strengthening the culture of the organisation. Of course, we have always said the turnaround will take time and there is further work ahead towards a full recovery.

As I said in our 2014 Annual Report and Accounts, we are well advanced in assembling a Board with the quality and experience to effectively oversee our transformation programme. In the first half of 2015, we welcomed two shareholder-nominated directors. Charles Bralver joined as a Non-executive Director in April 2015 and Aidan Birkett as an independent Non-executive Director in July 2015. We will make further announcements about the remaining positions in due course.

Values and ethics sit at the heart of the business. We have a strong environmental record and act as a force for good in the communities in which we operate. In July, the Bank built on its history of sustainability reporting with the publication of its first independent Values and Ethics Report, covering our activities in 2014 following the launch of our expanded Ethical Policy in January 2015. We look forward to reporting annually on the progress we are making in the new areas of the policy, including the development of our products and services for customers.

The transformation required to rebuild the Bank as a viable alternative to the traditional banks is not an easy task and we are very aware of the considerable challenges our colleagues have faced. On behalf of the Board I would like to express our gratitude for their ongoing commitment to serving customers, to customers for their continued loyalty and to investors for their support. There remains much to be done, but we are encouraged by the progress made towards building a sustainably profitable Bank that will meet the expectations of all of our stakeholders.

**Dennis Holt**
Chairman
19 August 2015

# Chief Executive's interim statement

Over the first half of 2015 the management team has continued to make real progress towards turning the Bank around. Our work to improve resilience, to bring aspects of our business back within our risk appetite and to reduce costs is on course, and we are encouraged by the headway we have made in this period. I would like to thank colleagues for their considerable dedication and perseverance as we reshape the business around our individual and small business customers.

The significant reduction in Non-core assets, including the first tranche of our Optimum disposal, and the actions we have taken to improve margins and address the underlying costs of the business continue to strengthen the Bank. The performance of the Core Bank is also beginning to improve as we increase efficiency, continue to re-invest in the brand and start working more closely with customers to develop products and services that better meet their needs.

As we have said before, the financial performance of the business will remain dominated by legacy issues for some time. However, this should not diminish the progress made against our strategic plan. We have come a very long way since June 2013 when our focus was to make sure the Bank avoided resolution and the need for financial support at the expense of the taxpayer. Since then we have raised an additional £1.9bn of Core Tier 1 and £250m of Tier 2 capital, renewed and strengthened our Board, improved our processes and overhauled our governance. There remains much work ahead but the actions we are taking are creating a resilient bank that can standalone, distinguished in the marketplace by its values and ethics. This is fundamental to driving value over time for all our stakeholders – customers, colleagues, shareholders and the communities we serve.

We also recently received the findings of the PRA and FCA investigations. As the Chairman noted at the time, the findings are serious and the Board takes their continued remediation seriously. Many of the issues raised have been addressed and in the case of others the remediation work is in progress. As we have noted several times, the biggest challenge will be changing some aspects of the culture of the organisation and, although there are early signs of encouragement, this is a process that will take some time. We are also continuing our work to embed and improve the Risk Management Framework which was a focus of both of the FCA and PRA investigations.

## Performance review

The Bank made considerable progress against its strategic plan in the first half of 2015. Alongside our success in deleveraging Non-core assets, which are down by £2.7bn in this period, operating costs were also reduced to £259.6m compared to £297.0m in the first half of 2014 as the Bank continued to rationalise its branch network, simplify its processes and reduce third party costs. In addition, the Bank's net interest margin increased by 12 basis points compared to the first half of 2014. This was largely driven by a reduction in the Bank's overall cost of funding as a result of lower prices for retail deposits. We also raised £250m of Tier 2 capital, further improving our financial resilience.

Fixing the legacy issues of the past will continue to impact the financial performance of the business for some time, and the statutory loss before taxation for the first half of 2015 was £204.2m. The main drivers were: the expected unwind of £54.3m of fair value adjustments (FVA) included as part of the Bank's plan; anticipated increased project spend year on year of £101.9m, required to progress the transformation and address the previous underinvestment in systems and processes; and net losses of £38.2m predominantly on sale of the Bank's Non-core assets as the Bank continued to deleverage these assets to build resilience. This compares to net gains on sale of £1.9m in the first half of 2014. Net impairment write backs reduced by £42.1m year on year to £44.6m, reflecting in part a strengthening domestic economy but also the work that was done in restructuring certain facilities.

Although there were no new significant categories of conduct issues in this period, the Bank adjusted the existing provision by an additional £49.0m, up from £38.6m on the same period the previous year. The conduct costs primarily comprise £20.0m of interest on non-CCA compliant unsecured loans, which will be refunded to the customer, and increases to the delivery costs of existing provisions for mortgages and unsecured loans of £15.0m. There is a further provision for the mis-selling of packaged accounts of £16.8m. No new provisions have been made for PPI but we have noted a possible risk around the recent Supreme Court Decision in the Plevin case. Compensation payments in respect of Interest Rate Hedging Products are now materially complete. Customer redress on the larger mortgages and CCA programmes has progressed in H1 with the launch of IT based solutions to improve the pace of customer contact. We intend to have substantially progressed the majority of conduct redress and remediation issues by the end of 2015.

## Increased capital and IT resilience

The Bank does not currently meet certain regulatory requirements and expectations. These deficiencies have existed for some time, and will continue for some years to come, and the Bank's plan is designed to remediate these over time.

The Bank continues to meet the revised plan accepted by the PRA to dispose of its Non-core assets and increase its capital resilience, with Non-core assets falling from £10.8bn at the end of 2014 to £8.0bn at the half year. There was a corresponding fall in total RWAs from £12.6bn to £10.1bn.

When we announced our 2014 results, we said that we would focus on the reduction of our Non-core residential mortgage portfolio (Optimum), which is particularly vulnerable to severe stress and consumes significant capital. We have made good progress on the disposal so far this year particularly given the capital market headwinds in the second quarter. The initial securitisation of £1.5bn of Non-core residential mortgage assets within the Optimum portfolio, the largest deal of this type in the UK market since 2007, has resulted in a corresponding net reduction of £0.8bn of Risk Weighted Assets (RWAs) and contributed to an improved CET1 ratio at 14.9% at the half year, up from 13.0% at the end of 2014. As we have said previously, we expect to continue to be loss making for at least 2015 and 2016 based on the level of investment required and the continued unwind of our Fair Value Adjustments (FVAs). In the short to medium term our CET1 ratio is still expected to reduce before it improves, due to the impact of RWA reduction being outweighed by the continued losses.

Whilst we have made progress in deleveraging the Optimum portfolio outlined above, we have also further strengthened the Bank's total capital resources through the successful raising of £250m Tier 2 capital, completed in June 2015. This was a significant achievement against a difficult market backdrop and will help the Bank comply with increasing regulatory capital requirements around bail-in-able resources.

We have continued to progress the migration of our IT infrastructure to IBM under the Enterprise Services outsourcing arrangement and this, along with other aspects of our IT remediation programme, has continued to improve our IT resilience in the first half of 2015.

## Liquidity

The Bank has taken action to lower the level of liquidity that was required to be built up during the issues faced in 2013. This has mainly been delivered by re-pricing certain retail deposits in line with the market, which has led to a managed reduction in deposits and a managed reduction in liquidity. This has also been a major contributory factor in the improved margin seen in the first half of the year.

## Core Bank

### Financial performance

It remains early days in the re-building of the retail business but we are making progress at this stage in our turnaround. The performance has stabilised, we are returning to a more normalised position in key product areas and continuing to position the bank as a credible provider of banking services.

During the first half of this year we have seen a stronger performance across our key products compared to H1 2014. Mortgage completions have increased, building on the progress made in the second half of 2014 when we disclosed an improved mortgage pipeline through our intermediary business Platform. This has converted into strong intermediary completions for the first half of 2015. Both mortgage applications and completions have increased year on year with completions totalling £1.1bn compared to £0.2bn for the first half of 2014 and £0.9bn in the second half of 2014. Mortgage outflows have also trended downwards in this period but remain an area of focus. Overall this has led to greater stability in net mortgage balances although expected repayments mean that the overall balance of mortgage assets in the Core Bank has declined slightly in the first half of 2015.

We will continue to focus on our mortgage business in the second half of the year, although the market is becoming increasingly competitive and net growth will continue to be impacted by the run off from Standard Variable Rate (SVR) products and people taking the opportunity of rising house prices and therefore higher levels of equity to refinance.

The Bank has continued to rebalance its savings portfolio in this period reflecting a reducing funding requirement from the Non-core business, greater stability in our business and less requirement for a sizable liquidity buffer. As a result, we have taken action to bring the pricing of certain retail deposits in line with the market. This has led to a managed reduction in deposits overall, reduced funding costs and improved net interest margin.

We have further developed our credit card offering, with the successful launch of a 3 year fixed rate card, aiming to offer customers some protection against future interest rate rises.

Retail current account numbers remained broadly stable throughout H1 2015 and we continue to re-establish the Bank's position in a very competitive market. The launch of a new overdraft proposition in April this year has been positively received and is the first product to be co-created with customers on the back of the expanded Ethical Policy launched in January. It is the first step in making our current account offer more compelling. Fewer customers are choosing to move their accounts away from the Bank and overall there was a net outflow of 2,250 current accounts in the first half of 2015 compared to 62,646 in same period last year. We are currently developing a new current account, based on input from our customers, as we continue the work to re-establish the Bank's position in a very competitive market.

Our SME business has remained broadly stable at the reduced level we have seen of late. We have recently begun to focus more on this aspect of our business and we will provide further updates on our plans in this area as appropriate.

Delivering a first-class and frictionless banking service to our customers, which enables them to bank, how, where and when they choose is key moving forward. Our aim remains to provide branches, where we know they are well-used, in parallel with our digital and telephone channels. Digital is now the channel of choice for many of our customers and we are continuing to invest in it, reflecting customers' changing preferences for how they do their day-to-day banking. Customers are embracing the recent improvements made to our digital banking functionality with over 700,000 now actively using online and mobile banking and over 213,000 customers have switched to paperless statements.

### Brand investment

Alongside this, our continued brand investment is building greater customer engagement and restoring trust in the brand. We are not trying to be a bank for everyone but we are making progress rebuilding trust and consideration amongst customers who, like us, believe values and ethics have an important role to play in banking. The response to our advertising campaign in the second quarter of this year, based around our ethical credentials, along with the work on products and the relaunch of the ethical policy continued to improve the customer perception of the Bank. We are ranked 3rd in the market for both Current Account Net Promoter Score (since October 2014) and Current Account Customer Satisfaction (since December 2013) and closing the gap to second place. We will continue to invest further in our brand over the rest of 2015, and to work with our customers to deliver better products for them.

### Cost challenges

Critical to the future health of the business is building a more efficient and effective model for the Retail Bank. This, of course, involves difficult people decisions but it is vital that our cost reduction programme in the Core Bank remains on track. The 57 branch closures, announced in February 2015, were completed by July 2015 and, as the business has continued to restructure and improve its processes, overall operating staff numbers have continued to fall. For the first half of this year permanent FTE has remained fairly stable but there have been significant reductions in the number of contractors. In the branch network, the digital take up by customers has contributed to a reduction in volumes of transactions of 28%. From January to June 2015 branches have been reduced by 26% and staffing levels have also reduced accordingly. This is not a sustainable level of reduction but it does show we are taking the right action in response to changing market conditions in how customers wish to conduct their day to day banking.

### Transformation

The transformation of the Bank remains challenging and work in progress.

We remain focused on achieving capital, IT and operational resilience. We have made good progress and become more resilient every day but this will remain a continued focus for the management team for some time. We have also made progress separating the infrastructure of the Bank from The Co-operative Group and we have begun the work to migrate our IT infrastructure to IBM, which will strengthen our technology platform.

As noted above we have continued work on the embedding of our Risk Management Framework. This will in time allow a more accurate picture of our non-credit, non-market related capital requirements to evolve.

There are significant transformation projects underway in the Bank and we are focused on managing these projects to achieve the continued cost reduction required throughout the plan through improved processes; efficiency savings through outsourcing of some back office functions; greater levels of digitisation; improved management and control of third party costs and the improved resilience of our IT platform.

## Outlook

We have delivered a number of important initiatives in line with our strategic plan and, although it remains early days, we are heading in the right direction. Our cost reduction targets are a challenging but important part of our plan.

The performance of the Retail Bank is improving and its future state is becoming clearer. We need to stay focused on keeping our products simple, maintaining our high level of service, securing the resilience of our IT platform, further embedding our Ethical Policy and reinforcing our Risk Management Framework.

Looking ahead, the deleverage of Non-core assets remains a key focus to improving capital resilience under stress and to delivering the plan. Future sales do, of course, continue to remain vulnerable to some level of market risk, which has increased over recent months, but we remain on track to reduce total RWAs to below £7.5bn by the end of 2017.

Our plan aims to meet the expectations of all our stakeholders. Firstly, it de-risks and reduces the possible burden on the taxpayer and any threat to the financial system as a whole. Secondly, over time it allows us to be an economically viable standalone bank, distinguished by our adherence to values and ethics. Finally, it rebuilds us as a bank that can play a role in any future consolidation in the marketplace. I am grateful for the support of colleagues, customers and shareholders as we continue to deliver against our plan and progress our turnaround.

**Niall Booker**
Chief Executive
19 August 2015

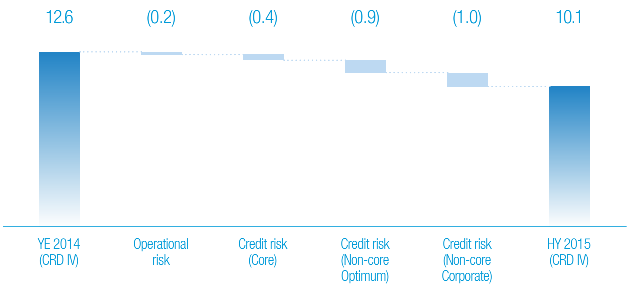
# Detailed financial review

## Capital

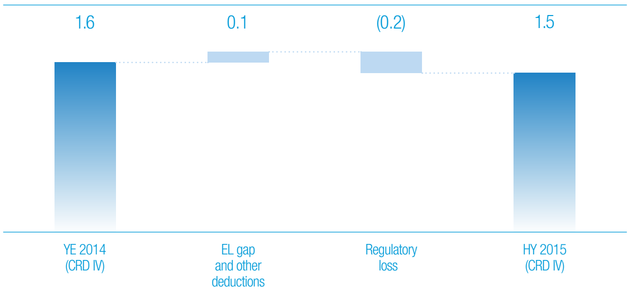
During 2015, the Bank has continued to make progress towards improving its capital position through reducing the overall risk profile of the Bank, primarily through securitisation of £1.5bn residential mortgages within the Non-core Optimum portfolio, resulting in a significant improvement in the capital position of the Bank.

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

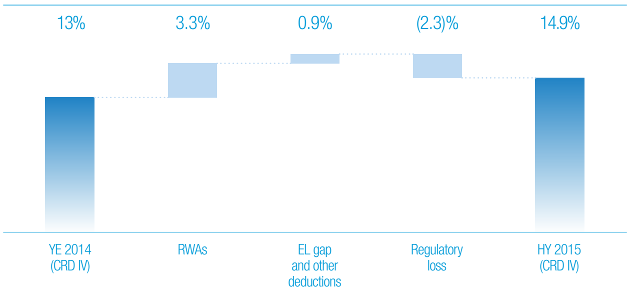
**Risk Weighted Assets £bn**




**Common Equity Tier 1 £bn**




**Common Equity Tier 1%**




## Capital position

| | **As at 30 June 2015** | As at 31 December 2014 | Change |
|---|---|---|---|
| **Capital ratios** | | | |
| Common Equity Tier 1 ratio (CET1) | **14.9%** | 13.0% | 1.9% |
| Total capital ratio | **17.1%** | 15.0% | 2.1% |
| | | | |
| **Risk weighted assets (RWAs) (£bn)** | **10.1** | 12.6 | (2.5) |
| **Leverage ratio** | **4.3%** | 4.2% | 0.1% |

The Bank's CET1 position has decreased by £0.1bn to £1.5bn, primarily as a result of the £233.1m statutory loss for the period, partially offset by a £118.9m reduction in the CET1 deduction for excess expected loss over impairment (EL gap) driven by a change in methodology to allow netting across defaulted exposures, in line with EBA guidance.

RWAs have decreased by £2.5bn since last year end. Non-core assets have been reduced in line with strategy and this is reflected in the £1.9bn reduction in Non-core RWAs. The securitisation of £1.5bn residential mortgages within the Non-core Optimum portfolio in May 2015 has resulted in a net £0.8bn reduction in RWAs. A £1.0bn RWA reduction in Corporate CoAM is driven by ongoing asset sales and deleveraging activity of the Non-core business. Operational risk RWAs have decreased by £0.2bn following the annual recalculation of the Pillar 1 operational risk requirement following the 2014 year end results.

These movements are the primary factors resulting in the Bank's fully loaded CRD IV CET1 ratio increasing by 1.9%, from 13.0% to 14.9%.

Leverage ratio is 4.3%, broadly stable with a 0.1% increase due to ongoing balance sheet deleveraging activity being offset by the reduction to Tier 1 capital resulting from the statutory loss for the period.

The Bank issued £250m of Tier 2 capital in June 2015. However, payment for this capital was not received until 1 July 2015, therefore in order to ensure compliance with CRR requirements for capital instruments to be fully paid up, the capital issuance has not been recognised within the Bank's capital resources until July 2015. If the issuance was included within June capital resources, the Bank's total capital ratio would have been 19.5%.

## Tier 2 capital issuance

| | As at 30 June 2015 | Impact of Tier 2 Capital Issuance | Proforma Including Tier 2 issuance 30 June 2015 |
|---|---|---|---|
| Tier 2 Capital | **£218.4m** | £249.3m | £467.7m |
| Total capital ratio | **17.1%** | 2.4% | 19.5% |

The Bank is currently redeveloping the model used to determine LGD for retail secured mortgages. The impact of applying the revised model to the Optimum portfolio was estimated to be a £1.0bn increase in RWAs and thus an RWA overlay for this amount was therefore raised in 2013 to reflect the difference between the existing and redeveloped LGD models. When the new LGD model goes live, the overlay will be released, with the new model directly calculating the appropriate LGD and corresponding RWA.

The overlay is static and is simply added to the calculated RWAs for Optimum. The reduction in assets and associated RWA in Optimum, has resulted in the overlay becoming proportionally much larger, which in turn has increased average risk weight % (RWA as a percentage of assets).

At 30 June 2015, the Bank was compliant with its Individual Capital Guidance (ICG), being the PRA's statement as to the regulatory capital (Pillar 2a) it expects the Bank to hold above Pillar 1, where Pillar 1 is the minimum required under the Capital Requirements Regulation. However, due to the Bank's ongoing losses, this position should be regarded as a very temporary situation. The Bank met the Pillar 1 capital requirement throughout the period.

The Bank's plan, which has been accepted by the PRA, anticipates that the Bank will meet the 7% CET1 ratio throughout the planning period and will have sustainably met ICG by the latter part of the planning period. The plan aims to build a sustainable Core Bank, and is designed to create a capital buffer by 2019 which would withstand a severe stress scenario equivalent to the 2014 Bank of England Stress test. The Bank anticipates that its leverage ratio will be sustainably above 3.0% by the end of the planning period.

## Liquidity

### Overview

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

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

- Reduce retail fixed term deposits to match the reduction of the balance sheet and reduce the cost of the liability base;
- Ensure the liquid asset buffer (LAB) predominantly comprises of highly liquid securities, allowing for limited reliance on short dated secured funding sources;
- Maintain the availability of mortgage collateral to support the secondary liquidity position;
- Repay wholesale funding to manage the balance sheet and the Bank's liquidity position.

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

### Credit rating

On July 31 2015, Moody's announced that the Bank's senior unsecured rating remains unchanged at Caa2 but now has a positive outlook. Moody's upgraded the Bank's Baseline Credit Assessment (BCA) from Ca to Caa2. However, Moody's removed any government support assumption leaving the overall rating unchanged at Caa2. The current ratings are:

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

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

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

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

iii. heightened collateral requirements within some clearing systems.

### Liquidity portfolio

The Bank's liquidity resources as at 30 June 2015 were £11.9bn compared to £12.1bn as at 31 December 2014. The table below analyses the Bank's liquidity portfolio by product and by liquidity value. Primary liquidity consists of liquid assets that are eligible under BIPRU 12.7 (LAB) and secondary liquidity consists of all other liquid assets (including self-issued retained securitisations and whole loans).

Despite the accelerated deleverage of the balance sheet in 2015, primary liquidity has decreased over the period by £466.6m and secondary liquidity has increased by £226.8m.

| | June 2015 £m | December 2014 £m | Change £m |
|---|---|---|---|
| Operational balances with central banks | **4,045.1** | 4,487.4 | (442.3) |
| Gilts | **1,276.4** | 1,246.7 | 29.7 |
| Central government and multilateral development bank bonds | **765.5** | 819.5 | (54.0) |
| **Total primary liquidity** | **6,087.0** | 6,553.6 | (466.6) |
| Total secondary liquidity | **5,793.6** | 5,566.8 | 226.8 |
| **Total liquidity** | **11,880.6** | 12,120.4 | (239.8) |

## Retail and commercial funding

The majority of the Bank's funding comes from retail and commercial accounts. As at 30 June 2015, customer deposits were £26.7bn compared to £29.9bn at 31 December 2014.

Retail deposits reduced over the period by £2.8bn. This forms part of the Bank's strategy to reduce its retail deposits to match the reduction in the balance sheet and to reduce the cost of liabilities.

The total amount of the Bank's corporate deposits reduced by £0.3bn over the period. This was due to the planned reduction in Non-core liability balances.

| | **June 2015 £m** | December 2014 £m | Change £m |
|---|---|---|---|
| **Current accounts** | | | |
| Retail | **3,644.5** | 3,479.3 | 165.2 |
| Corporate | **2,208.8** | 2,346.1 | (137.3) |
| **Total current accounts** | **5,853.3** | 5,825.4 | 27.9 |
| Instant access savings accounts | | | |
| Retail | **6,748.8** | 7,936.9 | (1,188.1) |
| Corporate | **522.5** | 584.0 | (61.5) |
| **Total instant access saving accounts** | **7,271.3** | 8,520.9 | (1,249.6) |
| Term deposits and bonds | | | |
| Retail | **6,555.4** | 7,675.6 | (1,120.2) |
| Corporate | **353.8** | 431.6 | (77.8) |
| **Total term deposits and bonds** | **6,909.2** | 8,107.2 | (1,198.0) |
| Individual savings accounts (ISA): | | | |
| Retail – ISA Fixed | **3,047.3** | 3,557.4 | (510.1) |
| Retail – ISA Demand | **2,607.3** | 2,745.9 | (138.6) |
| **Total ISA accounts** | **5,654.6** | 6,303.3 | (648.7) |
| Other deposits | **987.9** | 1,121.0 | (133.1) |
| **Total customer deposits** | **26,676.3** | 29,877.8 | (3,201.5) |

## Wholesale funding

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

The Bank redeemed the Silk Road Finance Number One securitisation in March 2015 of c. £1.1bn. The Warwick Finance 1 transaction completed in May provided net funding proceeds of c. £0.8bn. The Bank redeemed the fully retained Leek 20, 21 and 22 and Cambric 1 securitisations in the period; this unencumbers the underlying Non-core mortgages.

| | **June 2015 £m** | December 2014 £m | Change £m |
|---|---|---|---|
| Preference shares, PSBs and subordinated debt | **445.1** | 196.4 | 248.7 |
| Secured funding | **2,043.4** | 2,521.8 | (478.4) |
| Repos | **610.2** | 500.6 | 109.6 |
| Market borrowing | **11.4** | 46.0 | (34.6) |
| MTNs | **764.4** | 832.9 | (68.5) |
| **Total wholesale funding** | **3,874.5** | 4,097.7 | (223.2) |

The table does not include the Funding for Lending Scheme (FLS). The Bank repaid £200m of its FLS liability in the period. Funding provided by the FLS at the end of the period was £350m.

Figures are based on nominal values and accrued interest as at 30 June 2015 and 31 December 2014.

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

| | **June 2015 £m** | December 2014 £m | Change £m |
|---|---|---|---|
| Repayable in less than 1 month | **449.1** | 84.8 | 364.3 |
| Repayable between 1 and 3 months | **–** | 324.1 | (324.1) |
| Repayable between 3 and 12 months | **532.5** | 389.8 | 142.7 |
| Repayable between 1 and 5 years | **652.5** | 580.8 | 71.7 |
| Repayable in more than 5 years | **2,240.4** | 2,718.2 | (477.8) |
| **Total** | **3,874.5** | 4,097.7 | (223.2) |

## Deleveraging the Non-core Optimum Business

The Bank's plan requires a reduction in Non-core assets, which are particularly vulnerable to the Bank of England's hypothetical severe stress. The reduction in the size of the Optimum portfolio will significantly improve the Bank's resilience to a severe economic downturn.

On 6 May 2015 the Bank successfully closed its inaugural whole structure securitisation of part of its Non-core Optimum residential mortgages portfolio through the issuance of notes and residual certificates by Warwick Finance Residential Mortgages Number One plc ("Warwick Finance 1").

Warwick Finance 1 comprises a portfolio of £1.5bn residential mortgages issuing rated Residential Mortgage Backed Securities (RMBS) and residual certificates to investors. In addition the Bank retained 65% of the Class A Notes on settlement. The Class A Note retention is the only position retained by the Bank within the Warwick Finance 1 capital structure.

The successful completion of the transaction formed a key component of the Bank's plan to accelerate the de-leveraging of its Non-core assets, in which Optimum is included.

## Overall impact of the Warwick Finance 1 transaction

The table below shows the effect of the Warwick Finance 1 transaction on Optimum's balance sheet:

| | 31 December 2014[1] £m | Contractual repayments £m | Redemptions £m | Possession sales £m | Allowance for losses[2] £m | Fair value amortisation £m | Other £m | Pre-Warwick June 2015 £m | Impact of Warwick Finance 1 Transaction £m | Accounting reclassification required post Warwick Finance 1 Transaction £m | **30 June 2015[3] £m** |
|---|---|---|---|---|---|---|---|---|---|---|---|
| **Optimum Balance Sheet** | | | | | | | | | | | |
| Gross customer balances | 6,450.1 | (35.7) | (191.9) | (9.4) | – | – | (0.1) | 6,213.0 | (1,493.7) | – | **4,719.3** |
| Allowance for losses | (21.9) | – | – | – | 14.2 | – | 0.4 | (7.3) | 18.2 | (20.4) | **(9.5)** |
| Fair value adjustments | (76.3) | – | – | – | – | 1.5 | 0.1 | (74.7) | 4.6 | 20.4 | **(49.7)** |
| Other accounting adjustments | 4.3 | – | – | – | – | – | 15.7 | 20.0 | – | – | **20.0** |
| **Net carrying value** | 6,356.2 | (35.7) | (191.9) | (9.4) | 14.2 | 1.5 | 16.1 | 6,151.0 | (1,470.9) | – | **4,680.1** |

1,3. Refer to Risk Management section for further information on loans and advances to customers.
2. £14.2m decrease to allowance for losses, including parameter refresh and improvement in underlying asset quality.

The net cash proceeds were £1,483.8m (after £36.9m build out of the general reserve in Warwick Finance 1), giving rise to a £9.9m loss on disposal of £1,493.7m gross loans and advances before the associated release of credit risk provisions, fair value reserves and transaction costs. Incorporating these elements, the overall impact on the Bank's income statement was £5.9m.

In addition, the Bank continues to hold £0.7bn of RMBS assets following retention of 65% of the Class A Notes on settlement. These assets are classified as Available for Sale. Refer to note 22.

The table below shows the overall effect of the Warwick Finance 1 transaction on the Bank's income statement:

| | Loss on disposal of assets £m | Release of allowance for losses £m | Release of conduct risk provision[1] £m | Release of merger fair value £m | Transaction costs £m | **30 June 2015 £m** |
|---|---|---|---|---|---|---|
| Net interest income | – | – | – | – | – | **–** |
| (Losses)/Gains on asset sales[2] | (9.9) | 18.2 | (4.2) | – | (7.0) | **(2.9)** |
| Non-interest income | – | – | – | – | – | **–** |
| **Operating income** | (9.9) | 18.2 | (4.2) | – | (7.0) | **(2.9)** |
| Operating expenditure | – | – | – | – | – | **–** |
| Projects | – | – | – | – | – | **–** |
| Impairment gains/(losses) on loans and advances[3] | – | – | – | (3.7) | – | **(3.7)** |
| **Operating result** | (9.9) | 18.2 | (4.2) | (3.7) | (7.0) | **(6.6)** |
| FSCS Levy | – | – | – | – | – | **–** |
| Share of post tax profits from joint ventures | – | – | – | – | – | **–** |
| Conduct/legal risk | – | – | 4.2 | – | – | **4.2** |
| Fair value amortisation | – | – | – | 8.3 | – | **8.3** |
| **Profit/(loss) before taxation** | (9.9) | 18.2 | – | 4.6 | (7.0) | **5.9** |

1. £4.2m Conduct Risk provision was transferred to Warwick Finance 1 as part of the transaction. Refer to note 22 for further information.
2. £2.9m total loss on asset sale is reflected in Non-core (losses)/gains on asset sales. Refer to page 16.
3. £3.7m impairment gain on loans and advances is reflected in Non-core impairment gains/(losses) on loans and advances. Refer to page 16.

## Impact on regulatory capital

The table below shows the effect of the Warwick Finance 1 transaction on the Bank's credit risk weighted assets (RWAs):

| | 31 December 2014 £m | Disposal of Optimum assets £m | Warwick Finance 1 Class A Notes £m | Other Movements £m | **30 June 2015 £m** |
|---|---|---|---|---|---|
| Optimum credit RWAs | 3,526.0 | (856.2) | – | (41.0) | **2,628.8** |
| Warwick Finance 1 RMBS credit RWAs[1] | – | – | 52.1 | – | **52.1** |
| Total | 3,526.0 | (856.2) | 52.1 | (41.0) | **2,680.9** |

1. Warwick Finance Residential Mortgages Number One plc RMBS are held within the Bank's Treasury business unit.

The Bank's credit RWAs have reduced by a net £804.1m as a result of the transaction.

At 30 June 2015, the Warwick Finance 1 transaction has contributed a benefit of 1.2% to the Bank's CET1 ratio, reflecting the £804.1m reduction in credit RWAs together with a £10.7m increase to Common Equity Tier 1 as a result of net gains on the disposal of assets (£5.9m) and a reduction in Expected Loss (EL) Gap (£4.8m).

## Fair value of the Optimum portfolio

Within the Optimum portfolio, the majority of assets are measured at amortised cost in accordance with the Bank's accounting policies as outlined in note 1 and note 20 of this document. The carrying value represents the gross customer balances less any allowance for losses and merger fair value adjustments. At 30 June 2015 the value was £4,680.1m (31 December 2014: £6,356.2m).

The fair values of the Optimum portfolio as per note 20 have been calculated using the future lifetime income approach. Under this approach, fair value is measured by determining discounted expected cash flows, derived using expected redemption profiles of the portfolio, and discounting these cashflows at current market rates for products with similar characteristics and risk profiles. The current market rate used is assumed to encompass the time value of money plus a risk premium to account for the inherent uncertainty in the timing and amount of future cash flows arising from a book of mortgage assets.

| | **30 June 2015** | | 31 December 2014 | |
|---|---|---|---|---|
| | **Carrying Value £m** | **Fair Value £m** | Carrying Value £m | Fair Value £m |
| **Optimum** | | | | |
| Loans and advances to customers | **4,680.1** | **3,946.6** | 6,356.2 | 5,113.1 |

The table above shows that the fair value of the Optimum portfolio is £733.5m lower than the carrying value as at 30 June 2015 reflecting the adopted approach to determining fair value as outlined above.

However, this fair value is not intended to represent the value which could be achieved as part of a structured disposal, as the valuation method is applied to the individual assets in the Optimum portfolio. The Bank sold the mortgage servicing rights to the residual noteholders in the Warwick Finance 1 transaction. If the notes are called there may be the potential for the residual noteholders to extract further value from the portfolio through alternative mortgage servicing arrangements.

Furthermore, the nature of the Warwick Finance 1 transaction, being a whole structure securitisation, enabled the Bank to achieve favourable pricing through stratification of the portfolio which allowed the Bank to better position the risk profile of the underlying mortgage assets to the purchasers' risk appetite. Additionally, other market conditions which could impact pricing in any such transaction include the market appetite for similar securities along with the available supply.

In summary, the fair values reported in note 20 under International Financial Reporting Standards (IFRS) may not represent the value achievable in a structured disposal. The value achieved may be impacted by the market conditions prevailing at that time and thus may not be achievable in any future transactions.

# 2015 financial performance

## Total Bank financial performance

The financial results for the first half of 2015 reflect the good progress made in delivering against the primary areas of focus outlined in the strategic plan, including reduction of the Bank's operating costs, continued deleverage of Non-core assets and investment to transform the Bank's core operations.

The Bank has continued to successfully deleverage its balance sheet whilst delivering a 12bps improvement in its net interest margin compared to H1 2014. This improvement is largely driven by a reduction in the Bank's overall cost of funding arising on both Retail customer deposits and wholesale funding structures. In addition, the Bank has successfully reactivated lending activity and has seen a significant increase in completions in the intermediary mortgage lending channel.

H1 2015 saw the successful completion of two significant transactions; the Warwick Finance 1 transaction whereby the Bank securitised £1.5bn of Non-core residential mortgage assets within the Optimum portfolio, the largest publically marketed deal of this type in the UK market since 2007, together with the issuance of £250.0m of Tier 2 capital.

The Bank has also delivered cost savings relative to the prior year, reflecting the progress made against the cost reduction initiatives. These are focused on the improvement and simplification of Bank processes in addition to third party savings and branch rationalisation, whilst significant investment has also been made to transform the business into a simpler and more efficient retail bank.

However, the financial performance of the business continues to be impacted by legacy issues as the Bank progresses with the transformation required, and this is reflected in the Bank's statutory loss before taxation for H1 2015 of £204.2m.

The numbers referenced and presented on these pages are on a management accounts basis. A reconciliation of these numbers to the statutory accounts basis is provided in the segmental information in note 4.

## Bank performance

| | **June 2015 £m** | Restated June 2014 £m | Change £m |
|---|---|---|---|
| Net interest income | **233.6** | 249.2 | (15.6) |
| (Losses)/Gains on asset sales | **(38.2)** | 1.9 | (40.1) |
| Non-interest income | **41.1** | 56.2 | (15.1) |
| **Operating income** | **236.5** | 307.3 | (70.8) |
| Operating expenditure | **(259.6)** | (297.0) | 37.4 |
| Projects | **(101.9)** | (68.8) | (33.1) |
| Impairment gains on loans and advances | **44.6** | 86.7 | (42.1) |
| **Operating result** | **(80.4)** | 28.2 | (108.6) |
| FSCS Levy | **(20.5)** | (25.3) | 4.8 |
| Share of post tax profits from joint ventures | **–** | (0.1) | 0.1 |
| Conduct/legal risk | **(49.0)** | (38.6) | (10.4) |
| Fair value amortisation | **(54.3)** | (41.2) | (13.1) |
| **Loss before taxation** | **(204.2)** | (77.0) | (127.2) |
| | | | |
| **Net interest margin** | **1.32%** | 1.20% | 0.12% |
| **Cost income ratio[1]** | **94.5%** | 97.2% | 2.7% |

1. Operating expenditure divided by operating income excluding (losses)/gains on asset sales.

The Bank's loss before taxation of £204.2m is £127.2m higher than H1 2014. The primary drivers for the loss are:

- net losses on asset sales of £38.2m (H1 2014: £1.9m net gain) as a result of the deleverage of Non-core assets to improve the Bank's stressed capital resilience;
- an overall net impairment gain of £44.6m (H1 2014: £86.7m), arising as a result of the targeted workout approach;
- an increase in project costs of £33.1m, to £101.9m, as the Bank takes steps forward to deliver the transformation required and address the historic underinvestment in systems and processes;
- £49.0m of conduct and legal risk charges, including increases to existing provisions for packaged accounts, mortgages and CCA, as the Bank continues to progress the remediation of impacted customers;
- £41.1m of non-interest income, a reduction of £15.1m compared to prior year following disposal of part of the ATM estate and an industry-wide impact of changing interchange fee regulations; and,
- operating expenditure of £259.6m (H1 2014: £297.0m). The reducing cost base reflects the progress made in the cost reduction programme, focused on the improvement and simplification of Bank processes in addition to third party savings and branch rationalisation.

Charges in respect of the Financial Services Compensation Scheme (FSCS) Levy have reduced on the comparative period to £20.5m (H1 2014: £25.3m). The unwind of the fair value adjustments associated with the merger of The Co-operative Bank and Britannia Building Society continues to impact the income statement with a charge of £54.3m (H1 2014: £41.2m).

## Operating expenditure

| | June 2015 £m | June 2014 £m | Change £m |
|---|---|---|---|
| Core direct costs | **(90.5)** | (98.5) | 8.0 |
| Non-core direct costs | **(6.1)** | (14.2) | 8.1 |
| **Total direct costs** | **(96.6)** | (112.7) | 16.1 |
| Operations and central costs | **(163.0)** | (184.3) | 21.3 |
| **Total operating costs** | **(259.6)** | (297.0) | 37.4 |
| **Of which: staff costs** | **(118.7)** | (127.8) | 9.1 |

Total operating costs reduced by £37.4m to £259.6m (H1 2014: £297.0m). The movement breaks down into the following categories:

- ATM savings as a result of a reduced ATM estate of £11.0m;
- Other cost reduction initiatives of £20.0m including savings arising from: branch rationalisation, FTE reduction, supplier contract management, fraud detection and recovery processes;
- One-off non-recurring savings in H1 2015 of £6.0m relating to property provisions; and
- H1 2014 included £10.2m of one-off costs not recurred in 2015.

These cost savings were partially offset by an increase in marketing spend related to the brand relaunch of £3.6m, pension costs increase of £2.0m and bonus increase of £3.0m.

Operating staff costs have decreased year on year by £9.1m to £118.7m (H1 2014: £127.8m). The operating staff numbers (full time equivalents, including contractors but excluding all project staff) have fallen by 191 to 5,850 (H1 2014: 6,041) and direct pay has fallen by £8.0m. This has been partially offset by increases in pension and bonus costs.

## Project expenditure

| | June 2015 £m | June 2014 £m | Change £m |
|---|---|---|---|
| Operational projects | **(21.5)** | (20.3) | (1.2) |
| Remediation, integration and resiliency projects | **(40.5)** | (20.9) | (19.6) |
| Strategic projects | **(39.9)** | (27.6) | (12.3) |
| **Total project expenditure** | **(101.9)** | (68.8) | (33.1) |

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

Operational projects relate to changes in the regulatory environment and smaller business led initiatives, including process improvements. H1 2015 expenditure was £21.5m and is broadly in line with prior year (H1 2014: £20.3m), ensuring the regulatory and mandatory requirements of the Bank are met.

Remediation, integration and resiliency projects spend was £40.5m (H1 2014: £20.9m) and includes IT remediation and resiliency along with activity associated with Bank separation. £17.3m of activity relating to Enterprise Services outsourcing and separation from The Co-operative Group has been expensed in H1 2015. The Bank also incurred costs of £23.2m on other projects including embedding new systems and processes.

Strategic projects include projects that are transformational in nature and deliver significant cost savings or income benefits to the business, including Branch Transformation, Digital and Mortgages outsourcing. Expenditure amounted to £39.9m in H1 2015 (H1 2014: £27.6m).

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

## Capital expenditure

| | June 2015 £m | June 2014 £m | Change £m |
|---|---|---|---|
| Operational projects | **0.8** | 2.7 | (1.9) |
| Remediation, integration and resiliency projects | **4.2** | 0.7 | 3.5 |
| Strategic projects | **30.2** | (5.3) | 35.5 |
| **Total project capital expenditure** | **35.2** | (1.9) | 37.1 |

Overall Capital Expenditure from projects amounted to £35.2m in the period to 30 June 2015. This relates to investment in improving the Bank's Digital offering, outsourcing of mortgages administration, upgrading the Bank's financial processes and improving its accounting capabilities in line with the strategic plan. The first six months of 2014 included a £5.8m impairment of work in progress assets within Strategic projects related to branch IT infrastructure.

In addition, the Bank had provisions of £112.3m as at 31 December 2014 relating to separation from The Co-operative Group, of which £36.6m has been utilised in 2015.

## Impairment gains and losses

| | June 2015 £m | June 2014 £m | Change £m |
|---|---|---|---|
| Core impairment | **(2.7)** | (1.5) | (1.2) |
| Non-core impairment | **47.3** | 88.2 | (40.9) |
| **Net impairment gains on loans and advances** | **44.6** | 86.7 | (42.1) |

The Bank recognised a net impairment gain of £44.6m in H1 2015 (H1 2014: £86.7m).

The Core Bank impairment charge of £2.7m (H1 2014: £1.5m) was primarily driven by underlying credit movements on the unsecured book, partially offset by improving HPI and lower secured balances.

The Non-core impairment gain of £47.3m (H1 2014: £88.2m) predominantly reflects the workout approach. Non-core corporate assets have been disposed of at favourable prices and, together with a number of loan restructures, resulted in the release of previously recognised impairment provisions driving a net impairment writeback of £50.7m.

## Conduct and legal risk

The Bank provided an additional £49.0m (H1 2014: £38.6m) during the first half of 2015 in respect of conduct and legal risk. This primarily comprises £20.0m pertaining to H1 2015 interest on non-CCA compliant unsecured loans which will be refunded to the customer, in addition to increases to existing provisions for Mortgages and CCA delivery costs of £15.0m. In addition, the provision for packaged accounts has been extended by £16.8m as a result of increased inbound complaints. This new component of packaged accounts remains susceptible to complaint volumes.

A 2014 decision of the UK Supreme Court (Plevin) held that, judged on its own facts, non-disclosure of the amount of commissions payable in connection with the sale of single premium PPI to a customer could create an unfair relationship under provisions of the UK Consumer Credit Act. In line with other banking industry participants, The Co-operative Bank plc is participating in an active financial services industry wide dialogue with the FCA and the FOS to determine any possible wider impact of such decision on its historical sales of single and repeat premium PPI. The decision has a potential impact on a number of the Bank's customers who may have a claim for PPI mis-selling and treatment of prior claims. Due to this uncertainty, it is not currently possible to estimate the financial impact the Plevin decision could have and there can be no assurance that the outcome of this matter will not be material.

The Bank also released £4.2m of provisions in relation to mortgages within the Optimum portfolio that have been transferred to Warwick Finance Residential Mortgages Number One plc as part of the securitisation.

## Business segment financial performance

| | **June 2015 £m** | Restated June 2014 £m | Change £m |
|---|---|---|---|
| Retail contribution | **152.0** | 177.7 | (25.7) |
| BaCB contribution | **21.7** | 20.8 | 0.9 |
| **Core contribution excluding Treasury/other** | **173.7** | 198.5 | (24.8) |
| Treasury/other contribution | **(5.1)** | (34.4) | 29.3 |
| **Core contribution result** | **168.6** | 164.1 | 4.5 |
| **Non-core contribution result** | **15.9** | 117.2 | (101.3) |
| Head Office Overheads | **(163.0)** | (184.3) | 21.3 |
| Project costs | **(101.9)** | (68.8) | (33.1) |
| **Operating result** | **(80.4)** | 28.2 | (108.6) |

Contribution is defined as a business unit's net income less impairment less direct costs. Head Office Overheads represents costs incurred in central functions not directly attributable to business units.

Core business contribution excluding Treasury is £24.8m down on H1 2014 as a result of reduced non-interest income, partially offset by lower direct costs.

Treasury/other contributed a loss of £5.1m (H1 2014: £34.4m) predominantly driven by lower direct costs, together with a small increase in net income reflecting reduced funding costs and lower losses on assets held at fair value through profit or loss.

Non-core contribution has decreased significantly to £15.9m (H1 2014: £117.2m), driven by losses on asset sales (£38.1m in H1 2015) and lower net impairment gains compared to the prior year.

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

## Core

| | **June 2015 £m** | Restated June 2014 £m | Change £m |
|---|---|---|---|
| Net interest income | **231.3** | 220.9 | 10.4 |
| Losses on asset sales | **(0.1)** | (2.1) | 2.0 |
| Non-interest income | **30.6** | 45.3 | (14.7) |
| **Net income** | **261.8** | 264.1 | (2.3) |
| Direct costs | **(90.5)** | (98.5) | 8.0 |
| Impairment losses on loans and advances | **(2.7)** | (1.5) | (1.2) |
| **Contribution result** | **168.6** | 164.1 | 4.5 |
| **Net interest margin** | **1.83%** | 1.59% | 0.24% |

| | **June 2015 £m** | December 2014 £m | Change £m |
|---|---|---|---|
| **Assets** | **25,365.5** | 25,476.2 | (110.7) |
| **Liabilities** | **30,344.0** | 33,391.0 | (3,047.0) |

Core Bank contribution, comprising Retail, BaCB and Treasury/other, was up £4.5m on H1 2014. Core Bank Liabilities have reduced significantly during the period to 30 June 2015, from £33,391.0m at 31 December 2014 to £30,344.0m at 30 June 2015 as the Bank's funding and liquidity requirements have reduced.

Retail contribution has fallen to £152.0m (H1 2014: £177.7m). This deterioration is reflective of a significant reduction in non-interest income following disposal of part of the ATM estate and the industry-wide impact of reduced interchange fee income.

BaCB contribution has increased £0.9m relative to H1 2014 although income has reduced following customer balance sheet contraction over the period.

Treasury/other has contributed a loss of £5.1m (H1 2014: £34.4m loss), primarily reflective of increased non-interest income following the repayment of £550.0m of Funding for Lending Scheme (FLS) balances since 30 June 2014, together with lower accounting volatility on assets held at fair value through profit or loss.

## Retail

| | June 2015 £m | June 2014 £m | Change £m |
|---|---|---|---|
| Net interest income | **204.9** | 201.5 | 3.4 |
| Non-interest income | **28.1** | 55.9 | (27.8) |
| **Net income** | **233.0** | 257.4 | (24.4) |
| Direct costs | **(76.4)** | (78.4) | 2.0 |
| Impairment losses on loans and advances | **(4.6)** | (1.3) | (3.3) |
| **Contribution result** | **152.0** | 177.7 | (25.7) |
| **Net interest margin** | **2.87%** | 2.53% | 0.34% |

| | June 2015 £m | December 2014 £m | Change £m |
|---|---|---|---|
| **Customer assets** | **14,187.5** | 14,611.4 | (423.9) |
| **Customer liabilities** | **22,729.5** | 25,562.3 | (2,832.8) |

The Retail business continues to benefit from the reactivation of new business origination activities in the year to 31 December 2014 following the previous prioritisation of liquidity needs over new business origination in the latter part of 2013 and early 2014. This renewed focus has helped drive an increase in mortgage completions to £1,084.0m in the first six months of 2015 compared to £921.0m in the last six months of 2014, with completions through the Bank's intermediary channel accounting for 88% of total Retail mortgage completions as the Bank's offering becomes more competitive in this segment. Alongside this increase in inflows, mortgage redemptions (excluding contractual repayments) have fallen £177.2m to £1,047.2m since the six months to December 2014, partly reflective of targeted retention initiatives.

Maintaining strong levels of liquidity was a focus for the first half of 2014. In the period to 30 June 2015 the Bank has continued to manage the reduction in high priced deposits by rebalancing its savings portfolio and bringing pricing of deposits in line with the market, enabling the Bank to develop a more sustainable cost of funding. As a result, Retail customer liabilities reduced by £2,832.8m to £22,729.5m.

Retail current account numbers have remained more stable in the first half of 2015, with a net outflow of 2,250 (30 June 2014: net outflow of 62,646). As outlined in the Chief Executive Statement earlier in this document work continues to re-establish the Bank's position in a very competitive market, and the proportion of prime accounts has also remained steady at 45.5% (30 June 2014: 45.5%).

Whilst Retail customer assets have reduced by £423.9m over the period to 30 June 2015 to £14,187.5m, both Retail net interest income and net interest margin have increased, reflecting a reduction in the Bank's interest expense on deposits and wholesale liabilities.

Retail non-interest income reduced to £28.1m (H1 2014: £55.9m), reflecting a reduction in income from Link interchange as a result of the sale of part of the ATM estate. In addition, industry-wide impacts of revised interchange regulations have reduced the Bank's card transaction fee income.

## Business and Commercial Banking (BaCB)

| | June 2015 £m | June 2014 £m | Change £m |
|---|---|---|---|
| Net interest income | **20.3** | 23.0 | (2.7) |
| Non-interest income | **5.6** | 7.9 | (2.3) |
| **Net income** | **25.9** | 30.9 | (5.0) |
| Direct costs | **(5.2)** | (8.7) | 3.5 |
| Impairment gains/(losses) on loans and advances | **1.0** | (1.4) | 2.4 |
| **Contribution result** | **21.7** | 20.8 | 0.9 |
| **Net interest margin** | **6.98%** | 5.70% | 1.28% |

| | June 2015 £m | December 2014 £m | Change £m |
|---|---|---|---|
| **Customer assets** | **554.0** | 620.0 | (66.0) |
| **Customer liabilities** | **2,775.0** | 2,837.0 | (62.0) |

The BaCB business H1 2015 contribution result of £21.7m (H1 2014: £20.8m) represents a £0.9m improvement on the prior year.

Customer liabilities reduced £62.0m to £2,775.0m reflecting fixed term deposit outflows following a change in BaCB's pricing strategy to more closely align to the market. In addition, customer assets decreased £66.0m to £554.0m (31 December 2014: £620.0m) largely as a result of out of cycle maturities, including repayment of The Co-operative Group balances.

Net interest income has reduced by £2.7m; however, the net interest margin has improved by 128bps to 6.98% (H1 2014: 5.70%). BaCB's balance sheet is in a net liability position and as a result its net interest margin is sensitive to reductions in customer assets.

Non-interest income has reduced by £2.3m to £5.6m as a result of the transfer of the Bill Payment service and associated income to Non-core operations.

## Treasury/Other

| | June 2015 £m | Restated June 2014 £m | Change £m |
|---|---|---|---|
| Net interest income | **6.1** | (3.6) | 9.7 |
| Losses on asset sales | **(0.1)** | (2.1) | 2.0 |
| Non-interest income | **(3.1)** | (18.5) | 15.4 |
| **Net income** | **2.9** | (24.2) | 27.1 |
| Direct costs | **(8.9)** | (11.4) | 2.5 |
| Impairment gains on loans and advances | **0.9** | 1.2 | (0.3) |
| **Contribution result** | **(5.1)** | (34.4) | 29.3 |
| **Net interest margin** | **0.12%** | (0.07%) | 0.19% |

Treasury net interest expense decreased by £9.0m to £0.3m (H1 2014: £9.3m), whilst net interest income in the Bank's Core – Other business unit, including Unity Trust Bank, increased by £0.7m to £6.4m.

Balances supporting the Bank's liquidity buffer – highly liquid eligible assets, including cash, gilts and multi-lateral development bonds – reduced by £1.5bn on an average basis when compared to the period to 30 June 2014 reflecting the reducing liquidity requirements of the Bank. This gave rise to a reduction in interest income from these assets.

Wholesale funding, specifically securitisation issuance and repos, reduced predominantly due to lower repo balances and the repayment of Silk Road 1 and 2 and Meerbrook 8. The reduced funding costs on lower balances were partially offset by lower internal income following the deleveraging of Optimum assets.

The Bank purchased £0.7bn of the Warwick Finance Retail Mortgages Number One plc RMBS senior tranche as part of the first phase of the Optimum asset disposal program. In addition to this a £250.0m Tier 2 subordinated debt issuance was successfully completed in June 2015. Although these balances are included in the balances presented above, neither of these transactions had a significant impact on Treasury net interest income as they were both completed towards the end of the period to 30 June 2015.

Non-interest income in the first half of 2015 was £15.4m higher than the period to 30 June 2014 due to lower (FLS) fees following a reduction in the FLS balance from £0.9bn at 30 June 2014 to £0.35bn at 30 June 2015. In addition to this, increased non-interest income also reflects lower accounting volatility on assets accounted for at fair value through profit or loss and a reduction in securitisation set-up costs.

## Non-core

| | **June 2015 £m** | December 2014 £m | Change £m |
|---|---|---|---|
| Corporate CoAM | **3,006.9** | 3,930.1 | (923.2) |
| Optimum | **5,021.0** | 6,822.9 | (1,801.9) |
| **Assets** | **8,027.9** | 10,753.0 | (2,725.1) |
| Corporate CoAM | **356.9** | 557.4 | (200.5) |
| **Liabilities** | **356.9** | 557.4 | (200.5) |
| | | | |
| **Customer assets** | **7,743.3** | 10,253.0 | (2,509.7) |
| **Customer liabilities** | **356.9** | 557.4 | (200.5) |

The Bank continues to perform against its targeted reduction of Non-core assets. These assets have a higher proportional risk weighting compared to Core Bank assets and deleverage reduces the Bank's exposure to credit risk, particularly under a severe stress scenario. Non-core customer assets decreased by £2,509.7m to £7,743.3m. This includes £1.8bn reduction in Optimum assets, comprising £1.5bn as a result of the Warwick Finance 1 transaction and £0.3bn of contractual repayments and redemptions.

On 10 December 2014 the Bank exchanged a sale and purchase contract for the sale of a portfolio of renewable energy assets with a carrying value of £323.0m. The transaction was conditional upon gaining consent to the transfer from the underlying borrowers. On 14 July 2015 the Bank successfully completed the sale of the first tranche of five loans with an aggregate carrying value of £47.6m.

Non-core liabilities have reduced by £200.5m to £356.9m in line with expectations. As the Bank continues its Non-core deleveraging strategy customers have migrated their accounts to other financial institutions.

| | **June 2015 £m** | Restated June 2014 £m | Change £m |
|---|---|---|---|
| Net interest income | **2.3** | 28.3 | (26.0) |
| (Losses)/gains on asset sales | **(38.1)** | 4.0 | (42.1) |
| Non-interest income | **10.5** | 10.9 | (0.4) |
| **Net income** | **(25.3)** | 43.2 | (68.5) |
| Direct costs | **(6.1)** | (14.2) | 8.1 |
| Impairment gains on loans and advances | **47.3** | 88.2 | (40.9) |
| **Contribution result** | **15.9** | 117.2 | (101.3) |

H1 2015 Non-core contribution of £15.9m (H1 2014: £117.2m) reflects net impairment gains on loans and advances of £47.3m (H1 2014: £88.2m). The specialist team continues to focus on distressed-asset workout and turnaround capability and this approach, together with the improving economic environment, has resulted in a write-back of previously recognised impairment of assets on disposal.

The Non-core result is further impacted by significant losses on asset sales of £38.1m (H1 2014: £4.0m gain) reflecting prevailing market conditions as the Bank executes the strategic deleverage of Non-core assets, together with a decrease in net interest income of £26.0m to £2.3m, following targeted asset reduction. Non-core losses on asset sales of £38.1m include £4.2m of Conduct Risk provisions relating to the Warwick Finance 1 transaction. Refer to page 10 for further information.

## Outlook

The Bank's overarching strategy remains unchanged. Good progress has been made in the first half of 2015 against objectives in the plan, however there is much work still to be done. The focus in the second half of the year will be continued deleverage of Non-core assets, investment in and simplification of the Bank's Core franchise and improvement of the Bank's capital resilience over the longer term.

Significant risks remain over delivery of the plan. Legacy conduct risk issues continue to impact the industry, whilst the Bank, along with all other financial institutions, is significantly impacted by changes in the economic environment.

The required remediation and strategic investment together with the continued unwind of fair value reserves recognised following the merger with the Britannia Building Society is expected to drive losses in the Bank in at least 2015 and 2016. As a result, the Bank's CET1 ratio is expected to reduce in the medium term, before it improves again.

# Principal risks and uncertainties

## Regulatory Position

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

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

### Capital

The Bank meets its Pillar 1 capital requirements under normal economic conditions. This is the minimum required under the Capital Requirements Regulation.

However, the Bank has insufficient capital to withstand a severe stress.

The Bank's revised plan is expected to remediate this position towards the end of the plan period (mainly through Risk Weighted Asset (RWA) reduction to reduce risks that the Bank is exposed to, and cost reduction to mitigate ongoing losses). During the year 2015 the Bank closed its inaugural whole structure securitisation of part of its Non-core Optimum residential mortgages portfolio through the issuance of notes and residual certificates by Warwick Finance Residential Mortgages Number One PLC ("Warwick Finance One") resulting in a net £0.8bn RWA reduction within the Non-core Optimum portfolio. The successful closing of this transaction forms a key component of the Bank's plan to accelerate the de-leveraging of its Non-core assets, including Optimum.

The PRA provides Individual Capital Guidance (ICG) for each bank. This represents guidance on the capital (Pillar 2a) a firm should hold over Pillar 1. Although the Bank was temporarily above ICG at 30 June 2015, the Bank has insufficient capital to sustainably meet its ICG until the later years of its plan.

The Bank's plan remediates this issue by 2018.

### Capital Requirements Regulations (CRR)

The Bank is not currently compliant with all of the requirements to model credit risk internally. The Bank has implemented a review of its credit risk model requirements against CRR and created a remediation plan which has been accepted by the PRA.

The Bank plans to continue to remediate this issue during 2015.

### Solo Consolidation

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

### Technology

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

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

The Bank has received written confirmation from the FCA that the technology issue detailed above constitutes a breach of the FCA's Threshold Conditions[1].

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

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

   The Bank is regulated by both PRA and FCA, and certain of the Bank's subsidiaries may in future also be regulated on an individual basis by the FCA.

## Background

The Bank faced an extremely difficult and unprecedented situation following its June 2013 announcement of a significant shortfall in CET1 of £1.5bn. Since then, elements of the uncertainty around the going concern status of the Bank have been removed with the successful completion of capital raising exercises – the LME in December 2013, the equity capital raising in May 2014, together with the receipt of The Co-operative Group's £333m capital contribution and the issuance of £250m subordinated Tier 2 notes in June 2015.

In December 2014, following the Bank's failure of the Bank of England Stress Tests, the PRA accepted a revised plan. The overarching strategy of the Bank remains the same, however the Bank has committed to an earlier deleverage of the Optimum portfolio than that contemplated by the original plan. This will have an impact on the Bank's income which will need to be offset by additional cost savings to enable the achievement of the cost income target by the end of the plan period. In May 2015, the Bank successfully closed its inaugural whole capital securitisation of approx. £1.5bn comprising part of the Optimum portfolio.

Overall, the turnaround is still in its early stages and there are significant challenges in its execution, although much progress has been made over the past 18 months. The Bank has a large number of remediation and redress programmes to implement along with substantial re-engineering of its operating model to reduce costs and improve efficiency and a very large and complex IT remediation programme. A failure to successfully implement or a delay in implementing the Bank's strategy and plans may adversely impact the Bank's business, operating results, financial condition and prospects, its regulatory capital position and its ability to comply with its regulatory requirements both in respect of capital and more generally (see previous page for more information).

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

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

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

| Principal Risks | Definition | Why this is important and how it is managed |
|---|---|---|
| **Credit risk** | The current or prospective risk to earnings and/or capital arising from a borrower's failure to meet the terms of any contract with the Bank or the various subsidiaries of the Bank or such borrower's failure to perform as agreed. | **Managing this risk is a fundamental part of what a bank does.** The Bank's exposure to this risk is reducing as the higher risk lending is deleveraged, however along with all other banks the Bank remains exposed to macro-economic, market wide risks such as issues with the housing market and interest rate changes. |
| **Liquidity and funding risk** | The risk that the Bank's resources will prove inadequate to meet its liabilities as they contractually fall due or as a result of any contingent or discretionary cash outflows that may occur in a stress. It arises from the mismatch of timings of cash flows generated from the Bank's assets and liabilities (including derivatives). Should additional liquidity be required during a time of stress this is likely to result in higher than anticipated funding costs which will negatively impact on retained earnings and therefore capital resources. | **The Bank is reliant on its retail deposit base as a major source of funding** and given the relative size of the Bank's retail deposit base as compared with other sources of funding, the Bank is particularly exposed to liquidity risks as a loss of confidence by customers may result in the loss of a high proportion of the Bank's funding. |
| **Market risk** | The risk that the value of assets and liabilities, earnings and/or capital may change as a result of changes in market prices of financial instruments. The majority of the Bank's market risk arises from changes in interest rates which is managed and hedged in line with the market risk policy to minimise earnings volatility. | **The treasury team manages interest rate risk.** More information can be found in the risk management disclosures. The success of the Bank's current deleverage strategy is particularly susceptible to market risk. |

| Principal Risks | Definition | Why this is important and how it is managed |
|---|---|---|
| **Operational risk (including legal risk)** | The risk of loss resulting from inadequate or failed internal processes, people and systems or external events. This encompasses the effectiveness of risk management techniques and controls to minimise these losses. Legal risk including litigation is also managed within this risk type. | **The Bank is subject to a number of specific issues in this area due to a lack of investment in systems and processes which has led to increased operational risk. In particular:**<br>**The Bank's IT system has been underinvested for a considerable period of time.** The Bank needs to urgently and significantly improve and re-engineer its existing IT platform as the existing infrastructure is unsuitable and inherently fragile. There are also concerns about its resilience as the Bank's IT disaster recovery plan is not proven end to end. In January 2015, the Bank entered into an Enterprise Services (ES) contract with IBM in order to address this risk, however until that work is completed the Bank is exposed to a higher risk of an IT failure causing material disruption to the Bank's products and services. There are considerable execution risks in a project of this scale and complexity, including the risk that costs may exceed those originally contemplated. The Bank's regulators are fully aware of the steps the Bank is taking to address these operational risks as discussed on page 17.<br>**Many of the Bank's business, operational, reporting and financial processes rely on significant manual intervention** which is inefficient and increases the risk of errors in the Bank's data and financial reporting. The Bank is subject to high levels of model risk which occurs as a direct result of weaknesses in the design or use of a model.<br>**The Bank's systems of control have been weak** and although the foundations of more robust controls, including the revised and updated RMF, have been laid, this is taking more time than anticipated and significant work to embed across the organisation. These include the need to enhance general IT controls, including logical access and controls over the management of financial and customer data. Poor systems and manual processes, many of which have not been integrated following the Bank's merger with the Britannia in 2009 exacerbate this risk. Until the risk framework is fully embedded there is increased risk that inadequate risk management could lead to exposures outside the Bank's risk appetite, unanticipated losses and regulatory censure.<br>**The Bank is outsourcing key aspects of its operations;** for example its mortgage processing to Capita, to enhance, modernise and ultimately make aspects of its operations more effective and cost efficient. Major outsourcing projects and contractual arrangements are complex to execute and manage. The Bank is exposed to the risk that any major outsourcing arrangements are not properly managed by the Bank or delivered upon as expected by the outsourced provider on an ongoing basis. In the case of the mortgage processing outsourcing this could expose the Bank to disruption in its mortgage business which would impact on a major aspect of its core banking business. |

| Principal Risks | Definition | Why this is important and how it is managed |
|---|---|---|
| **Operational risk (including legal risk)** continued | The risk of loss resulting from inadequate or failed internal processes, people and systems or external events. This encompasses the effectiveness of risk management techniques and controls to minimise these losses. Legal risk including litigation is also managed within this risk type. | **The Bank is in the process of separating from The Co-operative Group.** Currently, and into the medium term, the Bank depends on The Co-operative Group to provide a number of services including critical functions such as IT (until the ES arrangement with IBM described above becomes operational), personnel, assets and to on-supply certain services, data and assets by third party suppliers. The Bank also has significant counterparty exposure to The Co-operative Group. The ongoing separation project is complex and may be more costly than currently contemplated.<br>The Bank faces legal, financial and reputational risk where legal proceedings are brought against it including as a result of the Bank's day to day business activity or encouraged by adverse findings of various investigations into events and activities at the Bank. Liability for damages may be incurred by the Bank where third parties are harmed by the conduct of the Bank's business.<br>The Bank does not have a documented right to occupy a number of its main places of business which if unresolved could lead to disputes, additional cost and operational disruption. |
| **Reputational risk** | The risk associated with an issue which could in some way be damaging to the reputation of the Bank. Underlying issues amongst others arising as a result of: (i) the Bank's strategic decisions or business performance; (ii) an operational failure; or (iii) external perception. This may result in a requirement to hold additional liquidity in anticipation of a stress scenario, which is likely to negatively impact retained earnings over time and therefore capital resources. | **The Bank considers that its reputation as an ethically led organisation is critical to the success of the plan.** Generically, there is a risk that this reputation may be undermined. As the various investigations into past events at the Bank reach a conclusion, there is a risk that findings may adversely affect the Bank's reputation. In addition, the Bank's change in ownership structure at the end of 2013 and the necessity to make significant cost savings which will include inter alia branch closures and staff reductions increase this risk. The Bank will continue to rely on the Co-operative brand and therefore carries the risk that its brand will be damaged as a result of matters relating to The Co-operative Group. The Co-operative Bank trade mark belongs to the Bank. Please see the Corporate Governance Report on page 40 of the 2014 Annual Report and Accounts, for a fuller explanation of the principles governing the Bank's right to use the trade mark and the circumstances in which this could be challenged or removed. |

| Principal Risks | Definition | Why this is important and how it is managed |
|---|---|---|
| **Strategic and business risk** | The risk arising from changes to the Bank's businesses and the environment in which it operates, specifically the risk of not being able to carry out the Bank's business plan and desired strategy. This may result in the Bank having to hold additional capital and/or liquidity. This risk is covered by many areas of capital in Pillar II, specifically execution, concentration and liquidity risk. | **The Bank's plan to focus on becoming a smaller Core Bank is unproven and is in the early stages of implementation. The Bank does not have a track record in successful execution of the large scale change necessary.**<br>The plan involves concurrent transformational change, with a large component relating to IT, which may result in additional investment cost and delays to the plan. Any delay would require ongoing regulatory acceptance of these issues for a longer period of time which might not be forthcoming and could be withdrawn if the plan is not executed in line with regulatory expectations.<br>In order to meet the plan accepted by the PRA, the Bank must deleverage its Non-core assets, in particular the Optimum portfolio, in accelerated time scales. The Bank has commenced this process and closed a whole capital securitisation of approx. £1.5bn, comprising part of the Optimum portfolio, in May 2015.<br>Additional Tier 2 capital in a total amount of £400m is contemplated by the Bank's revised plan. The Bank completed the issuance of £250m Tier 2 capital in June 2015. Further additional equity and/or debt capital may be required, beyond that contemplated currently, because of increased capital requirements (applicable to the Bank or banks generally), actual costs and losses exceeding those estimated in the Bank's plan or if the Bank does not deliver on its plan as anticipated. The Bank may be unable to raise any Tier 2 or other forms of capital it may need on favourable terms, when needed, or at all. |
| **People risk** | People risk is the risk associated with the recruitment, employment and management of individuals within the Bank. A significant portion of the Bank's cost base is staff costs and so managing this resource within budget is key to cost reduction and therefore to retained earnings. This risk is captured within the operational risk framework. | **The Bank continues to be subject to increased risk in this area.** The Bank continues to suffer an elevated risk of being unable to retain and recruit suitably qualified personnel. This increases execution risk in the plan and reduces historical corporate knowledge. |

| Principal Risks | Definition | Why this is important and how it is managed |
|---|---|---|
| **Regulatory risk** | The risk of fines, public censure, limitation on business, requirements for legal or operational restructuring, or restitution costs arising from the failure to understand, interpret, implement and comply with UK and EU regulatory requirements. | **Along with the wider banking industry, the Bank must comply with multiple regulatory changes** which may add complexity to an already difficult technology, operational and prudential change programme.<br>There is also a risk that changes to regulatory requirements affect the Bank's ability to successfully implement its plan.<br>**The regulatory position of the Bank is described on pages 17 and 18 at the start of this section.**<br>As at June 2015, the Bank met its ICG, however this may be a temporary position and the Bank may not sustainably meet its ICG until the later years of its Plan. The PRA has accepted this position. The Bank is under intense regulatory scrutiny and expects such scrutiny to continue.<br>On 11 August 2015 the PRA and FCA published the outcome of their enforcement investigations into certain events which occurred and processes in place in the Bank within the period from July 2009 to the end of 2013. During this period, the PRA has found that The Co-operative Bank was in breach of Principle 3 (Management and Control) with respect to the Bank's control and risk management framework. The FCA found the Bank to have breached UK Listing Rule 1.3.3 in relation to two statements in the Bank's 2012 Annual Report and Accounts. In addition the FCA and PRA have both found that, from 25 April 2012 to 9 May 2013, that the Bank breached Principle 11 by failing to notify the FCA and PRA of intended changes to two senior positions (and the reason for those changes).<br>No fine has been imposed by the PRA or FCA. However, the terms of the public censures by the PRA and FCA made clear the seriousness with which the failings were regarded and expressly stated that if any future enforcement investigation into the Bank found serious and wide ranging failures the censure would be a relevant factor in determining the outcome.<br>However, while this concludes the PRA and FCA enforcement investigations relating to the Bank itself, there remain a number of further investigations covering some or all of the same time period and events affecting the Bank which are either underway or still to commence (being: investigations into certain former senior individuals at the Bank; the Financial Reporting Council investigation into the preparation, approval and audit of the Bank's financial statements up to and including the year ended 31 December 2012 which focuses on the role of the auditors and individual accountants; and the independent investigation ordered by HMT). Therefore although no fine has been imposed by the PRA and FCA as a result of their investigations, the Bank remains exposed to increased regulatory scrutiny, significant resource drain, damages, fines and costs, adverse publicity, reputational damage and litigation claims either as a result of the findings of the PRA and FCA investigations or the eventual outcome of any other investigations. |

| Principal Risks | Definition | Why this is important and how it is managed |
|---|---|---|
| **Conduct risk** | The risk that the Bank's behaviour, offerings or interactions will result in unfair outcomes for customers. | **The Bank is exposed to the inherent risks relating to the mis-selling of financial products,** acting in breach of regulatory principles or requirements and giving negligent advice or other conduct determined by the Bank or the regulators to be inappropriate, unfair or non-compliant with applicable law or regulations. Any failure to manage these risks adequately could lead to further significant provisions, costs and liabilities and/or reputational damage. The Bank's approach to provisions for historic mis-selling issues such as PPI, interest rate swaps and packaged accounts is based on the views and requirements of the regulator. Any change in the regulator's current approach, such as an extension of the period covered by the requirement for proactive contact with customers, or a revision of approach following the Supreme Court decision in Plevin, could have a material impact.<br>A 2014 decision of the UK Supreme Court (Plevin) held that, judged on its own facts, non-disclosure of the amount of commissions payable in connection with the sale of single premium PPI to a customer could create an unfair relationship under provisions of the UK Consumer Credit Act. In line with other banking industry participants, The Co-operative Bank plc is participating in an active financial services industry wide dialogue with the FCA and the FOS to determine any possible wider impact of such decision on its historical sales of single and repeat premium PPI. The decision has a potential impact on a number of the Bank's customers who may have a claim for PPI mis-selling and treatment of prior claims. Due to this uncertainty it is not currently practicable to provide an estimate of any financial impact the Plevin decision could have and there can be no assurance that the outcome of this matter will not be material.<br>The Bank is continuing its programme of a structured risk-based assessment, of which the primary focus is the discovery and remediation of existing and new conduct and legal issues. While much work has been undertaken and progress has been made in identifying conduct issues, no assurance can be given that further issues will not be identified, or that the already identified issues may not require further provision.<br>Projects to remediate these issues are underway however are costly, complicated and require significant data extracts and IT support to implement. Delays or failure to successfully implement redress to customers increases the costs to the Bank and may lead to regulatory sanction.<br>The Bank has initiated a redress programme in respect of various breaches of mortgage conduct of business rules. It is also the subject of a skilled persons review into potential detriment to its mortgage customers arising from, amongst other matters, arrears handling. The outcome of the review is uncertain but could potentially lead to enforcement investigations by the FCA.<br>The Bank continues to be exposed to the risks of non-compliance with the Consumer Credit Act (CCA). While the Bank has identified certain instances where its documentation or processes have not been fully compliant with the technical requirements, there may be other instances of non-compliance which have not yet been identified. Until remediation of the issues already identified is complete, the Bank remains in breach of the technical requirements of the Act and will be unable to enforce interest charges on the affected products. The consequences of non-compliance with the CCA can include interest and default charges paid by a customer in prior periods being required to be refunded and the customer agreement not being enforceable by the Bank without a court order until the breach is remedied. |

| Principal Risks | Definition | Why this is important and how it is managed |
|---|---|---|
| **Pension risk** | The risk to the Bank's capital and company funds from the Bank's exposure to scheme liabilities (to the extent liabilities are not met by scheme assets) and risks inherent in the valuation of scheme liabilities and assets. | **The Bank participates in two defined benefit pension schemes, both of which are currently in deficit and there is a risk that this will worsen over time:**<br>• The Pace scheme, whose sponsoring employer is The Co-operative Group. The Bank is a participating employer in this scheme.<br>• The Britannia scheme, now closed, whose sponsoring employer is CFSMS, guaranteed by the Bank.<br>• Refer to note 16 to the accounts for a more detailed discussion of the accounting for these schemes.<br>• The Bank has agreed to a share of the deficit funding up to July 2016, as described in note 16 and a liability for this has been recognised on the balance sheet. Once the Bank's share of Pace liabilities has been agreed, the Bank will account for the scheme on a defined benefit basis.<br>The Pace scheme is not currently sectionalised and operates on a 'last man standing' basis. The Bank's obligation to Pace would increase significantly if another large employer in the scheme were to become insolvent. There is uncertainty over how much the Bank will need to pay in the event of sectionalisation of the scheme. The Bank is in consultation in respect of closure of the defined benefit section of the scheme. |

# Responsibility statement

We confirm that to the best of our knowledge:

- The condensed set of financial statements has been prepared in accordance with IAS 34 Interim Financial Reporting as adopted by the EU; and
- The interim management report includes a fair review of the information required by:
  - DTR 4.2.7R of the Disclosure and Transparency Rules, being an indication of important events that have occurred during the first half of the financial year and their impact on the condensed set of financial statements; and a description of the principal risks and uncertainties for the remaining half of the year; and
  - DTR 4.2.8R of the Disclosure and Transparency Rules, being related party transactions that have taken place in the first half of the current financial year and that have materially affected the financial position or performance of the entity during that period; and any changes in the related party transactions described in the last annual report that could do so.

By Order of the Board

**Niall Booker**
Chief Executive
19 August 2015

## The Co-operative Bank plc Board of Directors:

| | |
|---|---|
| **Dennis Holt** | Chairman |
| **Niall Scott Kilgour Booker** | Chief Executive Officer |
| **Laura Martine Carstensen** | Non-Executive Director |
| **John Richard Coates** | Interim Senior Independent Director |
| **Richard Graeme Barclay Hardie** | Non-Executive Director |
| **Maureen Laurie** | Non-Executive Director |
| **William Gennydd Thomas** | Non-Executive Director |
| **Derek James Weir** | Non-Executive Director |
| **Charles Bralver** | Non-Executive Director |
| **Aidan Birkett** | Non-Executive Director |
| **John Baines** | Finance Director |

# Risk management

## For the period ended 30 June 2015

All amounts are stated in £m unless otherwise indicated

## Introduction

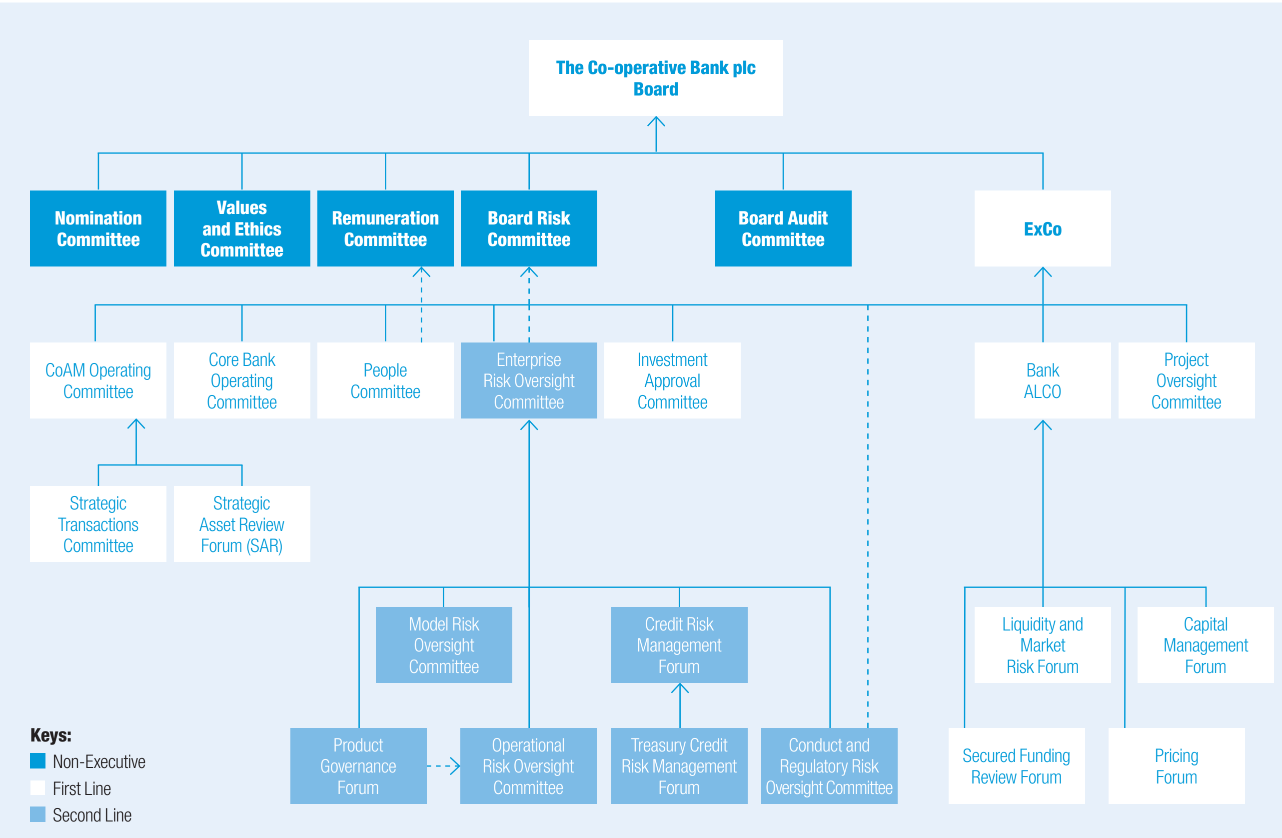
The Bank's risk management responsibilities are laid out in the Risk Management Framework, which creates clear ownership and accountability, with the purpose that the Bank's most significant risk exposures are understood and managed in accordance with agreed risk appetite, and there is regular reporting of both risk exposures and the operating effectiveness of controls. It includes those risks incurred by the Bank that are foreseeable, continuous and material enough to merit establishing specific Bank-wide control Frameworks.

As at 30 June 2015 there have been no significant changes to the Bank's principal Risks and Risk Management Framework. This framework is being reinforced in the second half of the year. The risks remain Credit Risk, Liquidity Risk, Market Risk, Operational Risk, Reputational Risk, Strategic and Business Risk, People Risk, Regulatory Risk, Conduct Risk and Pension Risk as per the 2014 Annual Reports and Accounts. An update to the risk taxonomy is in progress to bring in line with the current key risks to the Bank.

The Governance Structure has been refreshed primarily to reduce the number of committees by combining where appropriate, and to move to being oversight committees.

The Bank continues to operate the 'three lines of defence' governance model, to ensure appropriate responsibility and accountability is allocated to management, whilst recognising that the system is designed to manage rather than eliminate risk of failure to achieve business objectives. The risk focus of these Committees remains as per the 2014 Annual Report and Accounts.

The diagram below illustrates the Bank's Risk Management Committee structure as at 30 June 2015. The Bank continues to review and refine this structure.




First line Committees are responsible for ensuring that the risk and control environment is established and maintained in day-to-day decision making. The second line Committees give oversight and challenge to the first line and review.

All amounts are stated in £m unless otherwise indicated

# 1. Credit risk

## 1.1 Overview

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

## 1.2 Credit exposure

The following analysis of credit exposure shows:

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

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

| As at 30 June 2015 | Loans and advances to banks | Loans and advances to customers[1] | Investment securities | Derivative financial instruments | Total |
|---|---|---|---|---|---|
| **Analysis of balance in notes** | | **11** | **12** | | |
| Gross balance | **934.3** | **23,101.7** | **4,781.9** | **347.0** | **29,164.9** |
| Less: allowance for losses | **–** | **(466.9)** | **–** | **–** | **(466.9)** |
| | **934.3** | **22,634.8** | **4,781.9** | **347.0** | **28,698.0** |
| **Analysis of credit risk exposure** | | | | | |
| Not impaired | **934.3** | **21,438.8** | **4,781.9** | **347.0** | **27,502.0** |
| Impaired | **–** | **1,662.9** | **–** | **–** | **1,662.9** |
| | **934.3** | **23,101.7** | **4,781.9** | **347.0** | **29,164.9** |
| Credit commitments | **154.9** | **2,921.8** | **–** | **–** | **3,076.7** |
| **Gross credit risk exposure** | **1,089.2** | **26,023.5** | **4,781.9** | **347.0** | **32,241.6** |
| Less: Allowance for losses | **–** | **(466.9)** | **–** | **–** | **(466.9)** |
| **Net credit risk exposure** | **1,089.2** | **25,556.6** | **4,781.9** | **347.0** | **31,774.7** |

| As at 31 December 2014 | Loans and advances to banks | Loans and advances to customers | Investment securities | Derivative financial instruments | Total |
|---|---|---|---|---|---|
| Analysis of balance in notes | | 11 | 12 | | |
| Gross balance | 1,608.4 | 26,240.7 | 4,422.5 | 470.7 | 32,742.3 |
| Less: allowance for losses | – | (539.9) | – | – | (539.9) |
| | 1,608.4 | 25,700.8 | 4,422.5 | 470.7 | 32,202.4 |
| Analysis of credit risk exposure | | | | | |
| Not impaired | 1,608.4 | 23,827.2 | 4,422.5 | 470.7 | 30,328.8 |
| Impaired | – | 2,413.5 | – | – | 2,413.5 |
| | 1,608.4 | 26,240.7 | 4,422.5 | 470.7 | 32,742.3 |
| Credit commitments | 154.9 | 2,905.2 | – | – | 3,060.1 |
| Gross credit risk exposure | 1,763.3 | 29,145.9 | 4,422.5 | 470.7 | 35,802.4 |
| Less: Allowance for losses | – | (539.9) | – | – | (539.9) |
| Net credit risk exposure | 1,763.3 | 28,606.0 | 4,422.5 | 470.7 | 35,262.5 |

1. Includes assets held for sale of £ 246.3m (31 December 2014 £323.4m) – see note 21 for further details.

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

# 1. Credit risk continued

### Fair value adjustments

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

For the purposes of internal management reporting of coverage ratios and to better understand peer comparatives, loss provisions are grossed up by the amount of remaining credit fair value adjustments and compared to the gross amounts owed by customers, as shown in the Credit risk management section 1.3 Credit risk management.

## 1.3 Credit risk management

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

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

### 1.3.1 Loans and advances to customers

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

The decrease in impairment provisions in the period to 30 June 2015 for the Non-core Corporate division was driven primarily by the successful execution of the Non-core deleverage strategy and updated collateral values.

Worsening economic and market conditions, increasing interest rates, or a fall in house prices could all result in the Non-core assets suffering from more than expected impairments compared to the Core book. These additional impairments could adversely impact the Bank's operating results and financial position. In the longer term this could also impact its ability to comply with its regulatory capital requirements. The Non-core business' corporate asset book is also relatively concentrated, compared to the Core book, as a smaller number of borrowers account for a large proportion of the total loans outstanding. Any significant future impairment of these borrowers would result in a disproportionate impact on the Bank's operating results and financial position. As part of the revised plan the Bank announced its intention in 2014 to deleverage Optimum and the first tranche of this deleverage occurred in May 2015. Further tranche sales are expected during the remainder of 2015.

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

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

The disclosures in the secured residential credit risk, unsecured retail credit risk and corporate credit risk sections are all based on the gross customer balances in the above tables, unless otherwise stated.

All amounts are stated in £m unless otherwise indicated

# 1. Credit risk continued

| | Core | | | | Non-core | | |
|---|---|---|---|---|---|---|---|
| | Retail banking | | | | | | |
| **As at 30 June 2015** | **Secured** | **Unsecured** | **BaCB** | **Unity Trust Bank** | **Corporate** | **Optimum** | **Total** |
| **Analysis of balance in note 11** | | | | | | | |
| Gross loans and advances[1] | **13,328.5** | **924.5** | **584.1** | **183.9** | **3,391.1** | **4,689.6** | **23,101.7** |
| Less: allowance for losses | **(2.4)** | **(107.0)** | **(2.5)** | **(2.6)** | **(342.9)** | **(9.5)** | **(466.9)** |
| | **13,326.1** | **817.5** | **581.6** | **181.3** | **3,048.2** | **4,680.1** | **22,634.8** |
| **Analysis of credit risk exposure** | | | | | | | |
| Not impaired | **13,185.6** | **793.8** | **544.1** | **176.2** | **2,585.3** | **4,153.8** | **21,438.8** |
| Impaired | **142.9** | **130.7** | **40.0** | **7.7** | **805.8** | **535.8** | **1,662.9** |
| | **13,328.5** | **924.5** | **584.1** | **183.9** | **3,391.1** | **4,689.6** | **23,101.7** |
| Credit commitments | **491.1** | **1,913.2** | **187.0** | **42.5** | **288.0** | **–** | **2,921.8** |
| **Gross credit risk exposure** | **13,819.6** | **2,837.7** | **771.1** | **226.4** | **3,679.1** | **4,689.6** | **26,023.5** |
| Less: Allowance for losses | **(2.4)** | **(107.0)** | **(2.5)** | **(2.6)** | **(342.9)** | **(9.5)** | **(466.9)** |
| **Net credit risk exposure** | **13,817.2** | **2,730.7** | **768.6** | **223.8** | **3,336.2** | **4,680.1** | **25,556.6** |
| **Reconciliation of accounting to customer balances** | | | | | | | |
| Gross loans and advances | **13,328.5** | **924.5** | **584.1** | **183.9** | **3,391.1** | **4,689.6** | **23,101.7** |
| Fair value adjustments | **1.6** | **–** | **–** | **–** | **75.3** | **49.7** | **126.6** |
| Other accounting adjustments | **(83.9)** | **–** | **–** | **(2.7)** | **(14.8)** | **(20.0)** | **(121.4)** |
| **Gross customer balances** | **13,246.2** | **924.5** | **584.1** | **181.2** | **3,451.6** | **4,719.3** | **23,106.9** |

1. Includes assets held for sale of £ 246.3m (31 December 2014 £323.4m) – see note 21 for further details.

| | Core | | | | Non-core | | |
|---|---|---|---|---|---|---|---|
| | Retail banking | | | | | | |
| **As at 31 December 2014** | Secured | Unsecured | BaCB | Unity Trust Bank | Corporate | Optimum | Total |
| **Analysis of balance in note 11** | | | | | | | |
| Gross loans and advances | 13,570.2 | 1,067.9 | 649.1 | 175.2 | 4,400.2 | 6,378.1 | 26,240.7 |
| Less: allowance for losses | (2.2) | (106.1) | (3.6) | (2.6) | (403.5) | (21.9) | (539.9) |
| | 13,568.0 | 961.8 | 645.5 | 172.6 | 3,996.7 | 6,356.2 | 25,700.8 |
| **Analysis of credit risk exposure** | | | | | | | |
| Not impaired | 13,424.2 | 931.9 | 622.4 | 165.9 | 3,184.2 | 5,498.6 | 23,827.2 |
| Impaired | 146.0 | 136.0 | 26.7 | 9.3 | 1,216.0 | 879.5 | 2,413.5 |
| | 13,570.2 | 1,067.9 | 649.1 | 175.2 | 4,400.2 | 6,378.1 | 26,240.7 |
| Credit commitments | 346.3 | 2,013.1 | 249.8 | 44.3 | 251.7 | – | 2,905.2 |
| **Gross credit risk exposure** | 13,916.5 | 3,081.0 | 898.9 | 219.5 | 4,651.9 | 6,378.1 | 29,145.9 |
| Less: Allowance for losses | (2.2) | (106.1) | (3.6) | (2.6) | (403.5) | (21.9) | (539.9) |
| **Net credit risk exposure** | 13,914.3 | 2,974.9 | 895.3 | 216.9 | 4,248.4 | 6,356.2 | 28,606.0 |
| **Reconciliation of accounting to customer balances** | | | | | | | |
| Gross loans and advances | 13,570.2 | 1,067.9 | 649.1 | 175.2 | 4,400.2 | 6,378.1 | 26,240.7 |
| Fair value adjustments | 3.7 | – | – | – | 86.5 | 76.3 | 166.5 |
| Other accounting adjustments | (2.9) | (42.9) | 0.2 | – | (65.4) | (4.3) | (115.3) |
| **Gross customer balances** | 13,571.0 | 1,025.0 | 649.3 | 175.2 | 4,421.3 | 6,450.1 | 26,291.9 |

All amounts are stated in £m unless otherwise indicated

# 1. Credit risk continued

## Secured residential credit risk

### Acquisition and account management

Mortgages are loans to customers secured by a first charge over a residential property. Mortgages are originated directly to customers via branches, telephone and the internet under the Britannia and The Co-operative Bank brands, and via intermediaries under the Platform brand. In the first half of 2015, 12% (30 June 2014: 38%) of mortgages were originated directly and 88% (30 June 2014: 62%) through intermediaries.

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

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

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

The table below shows residential mortgage completions in the year, analysed by loan-to-value (LTV) and repayment method.

| | **As at 30 June 2015** | | | As at 31 December 2014 | | |
|---|---|---|---|---|---|---|
| | **Amount advanced** | **Average LTV %** | **Interest only %** | Amount advanced | Average LTV % | Interest only % |
| Retail prime | **153.0** | **60.4** | **0.9** | 291.7 | 56.2 | 1.1 |
| Platform prime | **748.4** | **73.4** | **–** | 771.3 | 67.4 | – |
| Total prime | **901.4** | **70.7** | **0.2** | 1,063.0 | 64.0 | 0.3 |
| Buy-to-let | **210.9** | **67.7** | **88.4** | 169.7 | 65.0 | 86.8 |
| Almost prime | **–** | **–** | **–** | 0.1 | 52.2 | – |
| **Total completions** | **1,112.3** | **70.1** | **16.9** | 1,232.8 | 64.2 | 12.2 |

A focused drive in intermediary introduced mortgages coupled with increased marketing of mortgage offerings has led to the level of completions for the 6 months to 30 June 2015 being at a similar level for the 12 months to 31 December 2014. Applications for lending at LTV higher than 85% increased through 2015 compared to 2014 which is reflected in the average LTV% of completions.

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

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

All amounts are stated in £m unless otherwise indicated

## 1. Credit risk continued

| | As at 30 June 2015 | | | | |
|---|---|---|---|---|---|
| | Retail secured | | Optimum | | |
| | Interest only | Other | Interest only | Other | Total |
| Less than 50% | 1,237.0 | 4,877.8 | 332.0 | 279.5 | 6,726.3 |
| 50% to 60% | 579.1 | 1,823.4 | 433.8 | 157.7 | 2,994.0 |
| 60% to 70% | 545.3 | 1,840.6 | 728.5 | 171.3 | 3,285.7 |
| 70% to 80% | 274.7 | 1,290.7 | 838.5 | 150.2 | 2,554.1 |
| 80% to 90% | 91.9 | 509.7 | 822.0 | 76.5 | 1,500.1 |
| 90% to 100% | 59.5 | 77.7 | 496.6 | 16.7 | 650.5 |
| Greater than 100% | 26.1 | 12.7 | 209.7 | 6.3 | 254.8 |
| | 2,813.6 | 10,432.6 | 3,861.1 | 858.2 | 17,965.5 |

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

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

| | As at 30 June 2015 | | | | | |
|---|---|---|---|---|---|---|
| | < 1 year | 1–5 years | 5–10 years | 10–20 years | 20+ years | Total |
| Retail secured | 109.0 | 331.7 | 543.6 | 1,363.4 | 465.9 | 2,813.6 |
| Optimum | 46.1 | 250.7 | 500.4 | 2,908.9 | 155.0 | 3,861.1 |
| | 155.1 | 582.4 | 1,044.0 | 4,272.3 | 620.9 | 6,674.7 |

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

All amounts are stated in £m unless otherwise indicated

## 1. Credit risk continued

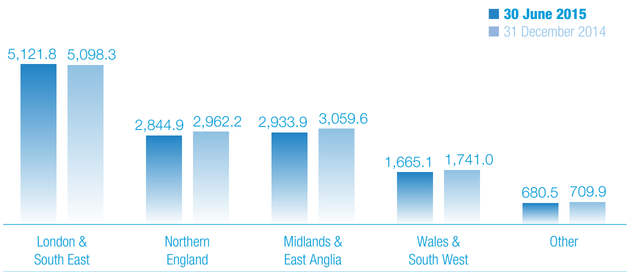
The table below shows gross customer balances for residential mortgages analysed by asset class, the LTV shown is the current average percentage:

| | **As at 30 June 2015** | | | | | |
|---|---|---|---|---|---|---|
| | **Retail secured** | | | **Optimum** | | |
| | **Gross customer balance** | **Average LTV %** | **Interest only %** | **Gross customer balance** | **Average LTV %** | **Interest only %** |
| Prime residential | **12,235.0** | **50.2** | **15.9** | **373.8** | **75.1** | **77.9** |
| Buy-to-let | **904.3** | **57.8** | **87.5** | **1,464.0** | **68.6** | **93.4** |
| Self-certified | **68.2** | **42.8** | **86.8** | **1,305.5** | **69.6** | **81.8** |
| Almost prime | **37.2** | **47.7** | **30.4** | **549.8** | **82.3** | **74.2** |
| Non-conforming | **1.5** | **58.6** | **50.2** | **1,026.2** | **71.4** | **70.8** |
| | **13,246.2** | **50.7** | **21.2** | **4,719.3** | **71.6** | **81.8** |

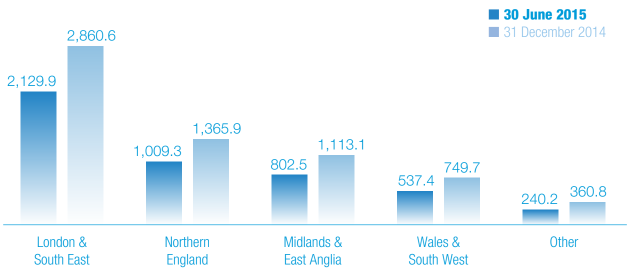
| | As at 31 December 2014 | | | | | |
|---|---|---|---|---|---|---|
| | Retail secured | | | Optimum | | |
| | Gross customer balance | Average LTV % | Interest only % | Gross customer balance | Average LTV % | Interest only % |
| Prime residential | 12,658.4 | 50.2 | 16.8 | 566.2 | 76.4 | 75.1 |
|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

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

**Retail secured**




**Optimum**



All amounts are stated in £m unless otherwise indicated

# 1. Credit risk continued

## Collateral

Mortgages are secured by a first charge over the property being purchased or remortgaged. Valuation of the property is normally assessed by a Royal Institution of Chartered Surveyors (RICS) certified surveyor from the Bank's approved panel. Valuations may also be assessed through the use of an automated valuation model (AVM).

The Bank reassesses the valuation of collateral for the non-default book on a quarterly basis using a regional property price index. The table below analyses the indexed value of property collateral held against mortgage portfolios:

| | As at 30 June 2015 | | | | | |
|---|---|---|---|---|---|---|
| | Retail secured | | | Optimum | | |
| | Gross customer balance | Collateral | Cover % | Gross customer balance | Collateral | Cover % |
| Impaired | **144.5** | **144.0** | **99.7** | **585.5** | **578.6** | **98.8** |
| Not impaired | **13,101.7** | **13,093.8** | **99.9** | **4,133.8** | **4,121.6** | **99.7** |
| | **13,246.2** | **13,237.8** | **99.9** | **4,719.3** | **4,700.2** | **99.6** |

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

## Impairment

The table shown below reports coverage ratios calculated using:

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

| | As at 30 June 2015 | | As at 31 December 2014 | |
|---|---|---|---|---|
| | Retail secured | Optimum | Retail secured | Optimum |
| **Gross loans and advances** | **13,328.5** | **4,689.6** | 13,570.2 | 6,378.1 |
| **of which impaired** | **142.9** | **535.8** | 146.0 | 879.5 |
| **Impaired as a % of gross loans and advances** | **1.1%** | **11.4%** | 1.1% | 13.8% |
| Allowance for losses | **2.4** | **9.5** | 2.2 | 21.9 |
| **Coverage** | **1.7%** | **1.8%** | 1.5% | 2.5% |

The movement in Optimum impairment provisions in the year to 30 June 2015 was driven by a combination of the securitisation of part of the Non-core Optimum portfolio, improvements in forecast house price movements reducing the anticipated shortfalls on properties expected to roll into default, and a reduction in overall asset levels as a result of the run-off of the portfolio, hence reducing the overall allowance for losses required.

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

All amounts are stated in £m unless otherwise indicated

## 1. Credit risk continued

In order to aid comparability with its peers, for internal management reporting purposes the Bank also calculates allowance for losses on the basis of amounts originally advanced to mortgagors, regardless of whether the Bank acquired or originated these mortgages. On this basis the Retail secured allowance for losses is £4.0m (2014: £5.9m) and the coverage ratio is 2.8% (2014: 4.0%) and the Optimum allowance for losses is £59.2m (2014: £98.2m) and the coverage ratio is 10.1% (2014: 10.3%).

The Bank regularly reviews its portfolio which includes a calculation of coverage ratios by reference to 90+ days past due and default balances. On this new basis:

- The Retail 90+ days past due and default balance is £50.8m (2014: £46.7m) 0.4% of total customer balances (2014: 0.3%) and the coverage ratio is 7.3% (2014: 12.7%); and
- The Optimum 90+ days past due and default balance is £319.9m (2014: £473.2m) 6.8% of total customer balances (2014: 7.3%) and the coverage ratio is 18.1% (2014: 19.8%).

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

| | As at 30 June 2015 | |
|---|---|---|
| | **Retail secured** | **Optimum** |
| Balance at start of the year | **146.0** | **879.5** |
| Classified as impaired during the period | **44.3** | **110.3** |
| Transferred to unimpaired during the period | **(31.6)** | **(149.0)** |
| Net repayments and other | **(15.8)** | **(305.0)** |
| Balance at the end of the period | **142.9** | **535.8** |

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

| | **As at 30 June 2015** | | | As at 31 December 2014 | | |
|---|---|---|---|---|---|---|
| | **Retail secured** | **Optimum** | **Total** | Retail secured | Optimum | Total |
| Low to medium risk | **12,826.6** | **3,164.3** | **15,990.9** | 13,155.0 | 4,153.3 | 17,308.3 |
| Medium to high risk | **275.1** | **969.5** | **1,244.6** | 269.9 | 1,341.0 | 1,610.9 |
| | **13,101.7** | **4,133.8** | **17,235.5** | 13,424.9 | 5,494.3 | 18,919.2 |

Low to medium risk is defined as exposures with a probability of default (PD) in the next year of 1% or below. Medium to high risk is defined as exposures with a PD in the next year of greater than 1%. All PDs are calculated using the internal ratings based (IRB) approach under Basel III.

### Forbearance

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

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

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

| | **As at 30 June 2015** | | | | As at 31 December 2014 | | | |
|---|---|---|---|---|---|---|---|---|
| **Retail secured** | **Neither past due nor impaired** | **Impaired** | **Loans subject to forbearance** | **Impairment** | Neither past due nor impaired | Impaired | Loans subject to forbearance | Impairment |
| Concessions | **4.9** | **5.0** | **9.9** | **–** | 5.8 | 4.5 | 10.3 | – |
| Arrangements | **11.7** | **13.5** | **25.2** | **(0.2)** | 14.2 | 18.7 | 32.9 | (0.4) |
| Term extensions | **51.1** | **0.6** | **51.7** | **–** | 123.7 | 0.4 | 124.1 | (0.3) |
| Assisted Voluntary Sale | **–** | **0.4** | **0.4** | **–** | – | 0.4 | 0.4 | – |
| Interest only switches | **4.3** | **0.4** | **4.7** | **(0.1)** | 8.3 | 0.8 | 9.1 | (0.2) |
| Capitalisations | **–** | **–** | **–** | **–** | 0.1 | – | 0.1 | – |
| | **72.0** | **19.9** | **91.9** | **(0.3)** | 152.1 | 24.8 | 176.9 | (0.9) |

All amounts are stated in £m unless otherwise indicated

# 1. Credit risk continued

| | As at 30 June 2015 | | | | As at 31 December 2014 | | | |
|---|---|---|---|---|---|---|---|---|
| **Optimum** | **Neither past due nor impaired** | **Impaired** | **Loans subject to forbearance** | **Impairment** | Neither past due nor impaired | Impaired | Loans subject to forbearance | Impairment |
| Concessions | **4.1** | **4.5** | **8.6** | **(0.1)** | 8.4 | 8.2 | 16.7 | (0.3) |
| Arrangements | **35.9** | **80.8** | **116.8** | **(4.3)** | 47.9 | 121.9 | 169.6 | (7.6) |
| Term extensions | **2.5** | **0.1** | **2.6** | **–** | 7.2 | 0.3 | 7.5 | (0.1) |
| Assisted Voluntary Sale | **–** | **1.1** | **1.1** | **(0.1)** | 0.1 | 1.1 | 1.2 | (0.1) |
| Interest only switches | **1.2** | **–** | **1.2** | **–** | 3.7 | 1.2 | 5.0 | (0.2) |
| Capitalisations | **–** | **–** | **–** | **–** | 0.1 | 0.1 | 0.2 | – |
| | **43.7** | **86.5** | **130.3** | **(4.5)** | 67.4 | 132.8 | 200.2 | (8.3) |

Retail forbearance balances have reduced by £85.0m (48%) since 31 December 2014 year end primarily due to the expiry of historical forbearance treatments (mainly term extensions).

Optimum forbearance balances have reduced by £69.9m (35%) since 31 December 2014 primarily due to the Tranche 1 sale being excluded, although a lower volume of arrangements has been observed on the remaining Optimum portfolio.

## Unsecured retail credit risk

### Acquisition and account management

The Bank offers unsecured lending through loans, credit cards and overdrafts. Customers' applications for credit are assessed using a combination of credit scoring and policy rules. Credit cards and overdrafts are subject to ongoing account management to determine any increase or decrease in credit limit that should apply as well as to manage over limit authorisations.

The portfolio risk is reassessed monthly using behavioural scorecards to determine the amount of capital required to be held for individual exposures.

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

| | **As at 30 June 2015** | As at 31 December 2014 |
|---|---|---|
| Loans | **371.8** | 436.7 |
| Professional and career development loans | **82.0** | 84.8 |
| Credit cards | **2,080.8** | 2,248.6 |
| Overdrafts | **303.1** | 310.9 |
| | **2,837.7** | 3,081.0 |

### Impairment

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

| | **As at 30 June 2015** | As at 31 December 2014 |
|---|---|---|
| **Gross loans and advances** | **924.5** | 1,067.9 |
| **of which impaired** | **130.7** | 136.0 |
| **Impaired as a % of gross loans and advances** | **14.1%** | 12.7% |
| Allowance for losses | **107.0** | 106.1 |
| **Coverage** | **81.9%** | 78.0% |

A reduction in gross loans and advances in the six months to 30 June 2015 is evident, however allowance for losses has increased marginally due to movement in asset quality. This has led to an increase in impairment coverage.

All amounts are stated in £m unless otherwise indicated

# 1. Credit risk continued

## Corporate credit risk

### Acquisition and account management

The Bank operates to a lending policy which is subject to meeting criteria as laid down in the corresponding sector strategy guidelines and strict policy with regards to single name and sector concentrations.

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

| As at 30 June 2015 | Standardised | Strong | Good | Satisfactory | Weak | Default | Total |
|---|---|---|---|---|---|---|---|
| **BaCB** | | | | | | | |
| Accommodation, food and licensed services | 11.1 | 15.0 | 29.3 | 4.5 | – | 0.1 | 60.0 |
| Care | 6.4 | 12.3 | 18.3 | 2.1 | – | 3.8 | 42.9 |
| Education | 50.5 | 1.7 | 1.3 | 2.2 | – | – | 55.7 |
| Financial services | 16.1 | 30.9 | 12.6 | 1.4 | 1.4 | 0.1 | 62.5 |
| Football clubs | – | – | – | – | – | – | – |
| Housing associations | 2.1 | 24.8 | 0.7 | – | – | – | 27.6 |
| Manufacturing | 1.6 | 12.3 | 0.6 | 0.1 | – | 0.4 | 15.0 |
| Motor trade and garages | 0.6 | 4.5 | 0.7 | 0.2 | – | – | 6.0 |
| PFI | – | – | – | – | – | – | – |
| Professional services | 7.6 | 6.2 | 2.8 | 0.3 | – | 0.2 | 17.1 |
| Property and construction: | | | | | | | |
| Commercial investment | 2.7 | 4.8 | 126.4 | 17.0 | 2.1 | 2.8 | 155.8 |
| Residential investment | 3.2 | – | 26.8 | 5.0 | – | 0.4 | 35.4 |
| Commercial development | – | 0.4 | 3.0 | – | – | 1.0 | 4.4 |
| Residential development | 0.3 | – | 4.2 | 0.6 | – | – | 5.1 |
| Public sector entities | 1.3 | – | – | – | – | – | 1.3 |
| Renewable energy | – | – | – | – | – | – | – |
| Retail and wholesale trade | 0.8 | 34.9 | 3.0 | 65.1 | – | 0.3 | 104.1 |
| Services | 62.7 | 12.4 | 33.2 | 3.7 | 0.1 | 0.7 | 112.8 |
| Transport, storage and communication | 1.6 | 6.1 | 0.9 | – | – | – | 8.6 |
| Utilities | 0.1 | 0.8 | – | 0.1 | – | – | 1.0 |
| Business banking | 0.2 | 41.4 | 5.9 | 2.8 | 0.5 | 0.6 | 51.4 |
| Other | 2.1 | 2.1 | 0.1 | 0.1 | – | – | 4.4 |
| **Total BaCB** | 171.0 | 210.6 | 269.8 | 105.2 | 4.1 | 10.4 | 771.1 |

The large reduction in BaCB exposures since December 2014 is primarily due to a significant debt repayment by one large connection.

All amounts are stated in £m unless otherwise indicated

## 1. Credit risk continued

| As at 30 June 2015 | Standardised | Strong | Good | Satisfactory | Weak | Default | Total |
|---|---|---|---|---|---|---|---|
| **CoAM** | | | | | | | |
| Accommodation, food and licensed services | 17.1 | 15.5 | 22.8 | 9.0 | 0.6 | 93.6 | 158.6 |
| Care | 26.4 | 28.6 | – | 4.7 | – | 38.4 | 98.1 |
| Education | 11.2 | 9.5 | 2.4 | – | – | 0.3 | 23.4 |
| Financial services | 0.1 | – | 3.4 | 0.4 | – | 1.6 | 5.5 |
| Football clubs | – | 18.7 | – | – | – | 1.1 | 19.8 |
| Housing associations | 5.0 | 740.9 | 0.1 | – | – | 0.3 | 746.3 |
| Manufacturing | 1.1 | – | – | 0.9 | – | 0.2 | 2.2 |
| Motor trade and garages | – | 1.4 | 0.1 | 0.5 | – | 2.0 | 4.0 |
| PFI | – | 55.5 | 825.2 | – | 1.9 | 18.4 | 901.0 |
| Professional services | 2.3 | – | 8.7 | 0.3 | – | 2.4 | 13.7 |
| Property and construction: | | | | | | | |
| Commercial investment | 15.7 | 24.3 | 268.6 | 100.1 | 52.5 | 426.3 | 887.5 |
| Residential investment | 4.5 | – | 47.1 | 38.9 | 14.7 | 80.6 | 185.8 |
| Commercial development | – | – | 9.1 | 3.7 | 2.0 | 85.3 | 100.1 |
| Residential development | 0.1 | – | 2.3 | 1.0 | 1.1 | 6.7 | 11.2 |
| Public sector entities | 50.6 | – | – | – | – | – | 50.6 |
| Renewable energy | 471.3 | – | – | – | – | 0.2 | 471.5 |
| Retail and wholesale trade | 0.4 | 2.2 | – | 1.6 | 0.1 | 6.1 | 10.4 |
| Services | 7.1 | 7.0 | 3.0 | 3.4 | 0.6 | 17.9 | 39.0 |
| Transport, storage and communication | 0.8 | – | 1.3 | 2.1 | – | 2.4 | 6.6 |
| Utilities | – | – | – | – | – | 3.9 | 3.9 |
| Business banking | – | – | – | – | – | – | – |
| Other | – | – | – | 0.3 | – | 0.1 | 0.4 |
| **Total CoAM** | 613.7 | 903.6 | 1,194.1 | 166.9 | 73.5 | 787.8 | 3,739.6 |
| **Total BaCB and CoAM** | 784.7 | 1,114.2 | 1,463.9 | 272.1 | 77.6 | 798.2 | 4,510.7 |

The reduction in Corporate CoAM exposures from £4,864.6m to £3,739.6m in the six months to 30 June 2015 reflects the continued deleverage of the portfolio. Significant deleverage activity has taken place in the Property & construction sector, primarily Commercial investment (£335m), PFI (£270m) and Housing associations (£127m) sectors.

All amounts are stated in £m unless otherwise indicated

## 1. Credit risk continued

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

All amounts are stated in £m unless otherwise indicated

## 1. Credit risk continued

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

All amounts are stated in £m unless otherwise indicated

# 1. Credit risk continued

## Collateral

Property valuations are obtained when the facility is first approved and our lending procedures typically require collateral to be revalued every two years or more frequently in higher risk situations (typically annually or when a material change has occurred that is likely to affect the value and/or recoverability of the debt).

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

| | **As at 30 June 2015** | | | As at 31 December 2014 | | |
|---|---|---|---|---|---|---|
| | **Exposure** | **Collateral** | **Impairment provision** | Exposure | Collateral | Impairment provision |
| **BaCB** | | | | | | |
| **Non-default loans with ≤1 year until refinancing and all defaulted exposures regardless of term** | | | | | | |
| Less than 50% | **37.6** | **37.5** | **0.1** | 27.4 | 27.2 | 0.1 |
| 50% to 60% | **13.8** | **13.8** | **–** | 3.1 | 3.1 | – |
| 60% to 70% | **6.2** | **6.2** | **–** | 1.7 | 1.7 | – |
| 70% to 80% | **0.3** | **0.3** | **–** | – | – | – |
| 80% to 90% | **–** | **–** | **–** | 0.9 | 0.9 | – |
| 90% to 100% | **–** | **–** | **–** | – | – | – |
| Greater than 100% | **0.8** | **0.6** | **0.1** | 0.1 | 0.1 | – |
| Unsecured | **42.4** | **–** | **1.6** | 88.5 | – | 1.2 |
| | **101.1** | **58.4** | **1.8** | 121.7 | 33.0 | 1.3 |
| **Non-default loans with >1 year until refinancing and all non-loan non-defaulted exposures regardless of term** | | | | | | |
| Less than 50% | **237.5** | **237.5** | **–** | 253.3 | 253.3 | 0.1 |
| 50% to 60% | **92.4** | **92.4** | **–** | 87.3 | 87.3 | – |
| 60% to 70% | **50.3** | **50.3** | **–** | 48.7 | 48.7 | – |
| 70% to 80% | **13.6** | **13.6** | **–** | 38.3 | 38.3 | – |
| 80% to 90% | **8.0** | **8.0** | **–** | 11.6 | 11.5 | – |
| 90% to 100% | **1.7** | **1.7** | **–** | 1.8 | 1.7 | – |
| Greater than 100% | **16.7** | **9.1** | **–** | 26.8 | 17.4 | 0.4 |
| Unsecured | **249.8** | **–** | **0.7** | 282.2 | – | 1.1 |
| | **670.0** | **412.6** | **0.7** | 750.0 | 458.2 | 1.6 |
| **Total BaCB** | **771.1** | **471.0** | **2.5** | 871.7 | 491.2 | 2.9 |

All amounts are stated in £m unless otherwise indicated

## 1. Credit risk continued

| | As at 30 June 2015 | | | As at 31 December 2014 | | |
|---|---|---|---|---|---|---|
| | **Exposure** | **Collateral** | **Impairment provision** | Exposure | Collateral | Impairment provision |
| **CoAM** | | | | | | |
| **Non-default loans with ≤1 year until refinancing and all defaulted exposures regardless of term** | | | | | | |
| Less than 50% | **58.5** | **43.7** | **14.8** | 33.5 | 32.5 | 1.0 |
| 50% to 60% | **121.4** | **118.6** | **2.8** | 72.4 | 70.3 | 2.0 |
| 60% to 70% | **30.6** | **27.8** | **2.8** | 86.5 | 85.8 | 0.7 |
| 70% to 80% | **49.7** | **40.3** | **9.4** | 44.3 | 41.2 | 3.1 |
| 80% to 90% | **68.5** | **61.2** | **7.3** | 106.9 | 89.8 | 17.1 |
| 90% to 100% | **85.9** | **77.6** | **8.3** | 88.4 | 77.8 | 10.6 |
| Greater than 100% | **296.1** | **155.0** | **134.4** | 576.6 | 311.2 | 227.8 |
| Unsecured | **264.9** | **–** | **223.9** | 264.3 | – | 193.8 |
| | **975.6** | **524.2** | **403.7** | 1,272.9 | 708.6 | 456.1 |
| **Non-default loans with >1 year until refinancing and all non-loan non-defaulted exposures regardless of term** | | | | | | |
| Less than 50% | **383.7** | **383.7** | **–** | 361.9 | 361.8 | 0.1 |
| 50% to 60% | **401.2** | **401.2** | **–** | 377.4 | 377.4 | – |
| 60% to 70% | **373.9** | **373.9** | **–** | 543.7 | 542.9 | 0.8 |
| 70% to 80% | **179.3** | **178.8** | **0.5** | 307.1 | 306.5 | 0.6 |
| 80% to 90% | **17.1** | **16.9** | **0.2** | 34.9 | 34.6 | 0.3 |
| 90% to 100% | **52.0** | **51.9** | **0.1** | 96.1 | 92.3 | 3.9 |
| Greater than 100% | **75.7** | **28.0** | **0.1** | 116.3 | 52.4 | 1.1 |
| Unsecured | **1,281.1** | **–** | **13.6** | 1,754.3 | – | 9.1 |
| | **2,764.0** | **1,434.4** | **14.5** | 3,591.7 | 1,767.9 | 15.9 |
| **Total CoAM** | **3,739.6** | **1,958.6** | **418.2** | 4,864.6 | 2,476.5 | 472.0 |

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

As at 30 June 2015 £16.6m (2014: £25.4m) of the above collateral is not held as first charge.

### Impairment

Corporate customers are placed on a watchlist and treated as impaired when they show signs of unsatisfactory performance and require close monitoring.

| | As at 30 June 2015 | | As at 31 December 2014 | |
|---|---|---|---|---|
| | **BaCB** | **CoAM** | BaCB | CoAM |
| **Gross loans and advances** | **584.1** | **3,391.1** | 649.1 | 4,400.2 |
| **of which impaired** | **40.0** | **805.8** | 26.7 | 1,216.0 |
| **Impaired as a % of gross loans and advances** | **6.8%** | **23.8%** | 4.1% | 27.6% |
| Individual allowance for losses | **1.5** | **327.1** | 1.4 | 386.8 |
| **Impairment coverage (excluding collective provisions)** | **3.8%** | **40.6%** | 5.2% | 31.8% |
| Collective allowance for losses | **1.0** | **15.8** | 2.2 | 16.7 |

All amounts are stated in £m unless otherwise indicated

## 1. Credit risk continued

The Bank manages recovery of customer arrears on a gross customer balance basis (excluding credit fair value adjustments and other accounting entries). Gross loans and advances to customers comprise mortgages that were acquired by the Bank at discounts to the amounts that were advanced to the mortgagors, and mortgages that were originated by the Bank. In order to aid comparability with its peers, and for internal management reporting purposes the Bank also calculates allowance for losses on the basis of amounts originally advanced to mortgagors, regardless of whether the Bank acquired or originated these mortgages. On this basis the BaCB allowance for losses is £1.5m (2014: £1.4m) and the coverage ratio is 3.8% (2014: 5.2%) and the CoAM allowance for losses is £402.4m (2014: £473.3m) and the coverage ratio is 45.7% (2014: 36.3%).

The movements in impaired customer balances during the year are shown below. The increase in impaired BaCB balances is primarily due to one large connection moving from Satisfactory to Watch List status.

| | **As at 30 June 2015** | | As at 31 December 2014 | |
|---|---|---|---|---|
| | **BaCB** | **CoAM** | BaCB | CoAM |
| Balance at start of the year | **26.7** | **1,216.0** | 15.6 | 1,977.8 |
| Classified as impaired during the period | **19.1** | **97.9** | 190.9 | 259.9 |
| Transferred to unimpaired during the period | **(5.0)** | **(118.7)** | (57.4) | (59.4) |
| Amounts written off | **–** | **(53.4)** | – | (178.2) |
| Net repayments and other | **(0.8)** | **(336.0)** | (122.4) | (784.1) |
| Balance at the end of the period | **40.0** | **805.8** | 26.7 | 1,216.0 |

### Forbearance

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

The table below analyses the exposures subject to forbearance:

| | **As at 30 June 2015** | | | As at 31 December 2014 | | |
|---|---|---|---|---|---|---|
| | **Forborne** | **Non-forborne** | **Total** | Forborne | Non-forborne | Total |
| **BaCB** | | | | | | |
| Default | **0.2** | **10.1** | **10.3** | 1.5 | 1.4 | 2.9 |
| On watchlist | **3.5** | **28.1** | **31.6** | 4.0 | 23.7 | 27.7 |
| Neither default nor on watchlist | **1.9** | **727.3** | **729.2** | 8.1 | 833.0 | 841.1 |
| **Total BaCB** | **5.6** | **765.5** | **771.1** | 13.6 | 858.1 | 871.7 |
| **CoAM** | | | | | | |
| Default | **335.1** | **452.6** | **787.7** | 418.6 | 607.5 | 1,026.1 |
| On watchlist | **53.1** | **67.6** | **120.7** | 125.4 | 99.6 | 225.0 |
| Neither default nor on watchlist | **0.5** | **2,830.7** | **2,831.2** | 50.4 | 3,563.1 | 3,613.5 |
| **Total CoAM** | **388.7** | **3,350.9** | **3,739.6** | 594.4 | 4,270.2 | 4,864.6 |
| **Total BaCB and CoAM** | **394.3** | **4,116.4** | **4,510.7** | 608.0 | 5,128.3 | 5,736.3 |

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

All amounts are stated in £m unless otherwise indicated

# 1. Credit risk continued

### 1.3.2 Investment securities

At the balance sheet date, the Bank has a total investment securities portfolio of £4,781.9m (2014: £4,422.5m) of which £nil (2014: £nil) is considered impaired. The following tables analyse the gross balance by impairment classification and type of investment security:

| | Investment securities | | | |
|---|---|---|---|---|
| As at 30 June 2015 | Loans and receivables | Available for sale | Fair value through income or expense | Total |
| **Analysis of balance in note 12** | | | | |
| Gross balance | **18.0** | **3,698.9** | **1,065.0** | **4,781.9** |
| Less: allowance for losses | **–** | **–** | **–** | **–** |
| | **18.0** | **3,698.9** | **1,065.0** | **4,781.9** |
| **Analysis of credit risk exposure** | | | | |
| Not impaired | **18.0** | **3,698.9** | **1,065.0** | **4,781.9** |
| Impaired | **–** | **–** | **–** | **–** |
| **Gross credit risk exposure** | **18.0** | **3,698.9** | **1,065.0** | **4,781.9** |
| Less: allowance for losses | **–** | **–** | **–** | **–** |
| **Net credit risk exposure** | **18.0** | **3,698.9** | **1,065.0** | **4,781.9** |

| | Investment securities | | | |
|---|---|---|---|---|
| As at 31 December 2014 | Loans and receivables | Available for sale | Fair value through income or expense | Total |
| Analysis of balance in note 12 | | | | |
| Gross balance | 18.1 | 3,167.5 | 1,236.9 | 4,422.5 |
| Less: allowance for losses | – | – | – | – |
| | 18.1 | 3,167.5 | 1,236.9 | 4,422.5 |
| Analysis of credit risk exposure | | | | |
| Not impaired | 18.1 | 3,167.5 | 1,236.9 | 4,422.5 |
| Impaired | – | – | – | – |
| Gross credit risk exposure | 18.1 | 3,167.5 | 1,236.9 | 4,422.5 |
| Less: allowance for losses | – | – | – | – |
| Net credit risk exposure | 18.1 | 3,167.5 | 1,236.9 | 4,422.5 |

Fair value adjustments relating to expected credit losses on assets obtained on merger with Britannia Building Society in 2009 are no longer shown separately, instead they have been allocated against the relevant assets.

All amounts are stated in £m unless otherwise indicated

# **1. Credit risk** continued

### Collateral

There are policies in place with regard to the management and valuation of collateral. Repos and secured lending positions are revalued daily and margin calls on collateralised swaps are made dependent on the counterparty. Eligible financial collateral for Basel III reporting purposes typically includes gilts held under reverse repo agreements and cash held under both repo agreements and collateralised swap arrangements. The Bank did hold some non-UK sovereign bonds as collateral for derivative exposures.

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

### Impaired assets

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

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

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

### Not impaired assets

The Bank only invests in treasury assets which comply with the Credit Risk Policy and Treasury Credit Risk Control Standard. Within the Treasury investment security portfolio 100% (2014: 100%) of exposures have an external credit rating equivalent to Fitch A or above.

### 1.3.3 Loans and advances to banks

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

### Derivative financial instruments

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

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

For non-collateralised derivatives, the Bank uses an internal credit rating approach to adjust fair values for credit risk of the counterparty. The Credit Value Adjustment (CVA) was £3.4m (2014: £3.9m).

| | **As at 30 June 2015** | | As at 31 December 2014 | |
|---|---|---|---|---|
| | **Derivative notional (net)** | **Derivative fair value (net)** | Derivative notional (net) | Derivative fair value (net) |
| **Interest rate** | | | | |
| Bi-lateral collateral agreements | **13,209.6** | **(309.7)** | 12,930.5 | (399.3) |
| One way collateral agreements | **2,251.8** | **28.9** | 3,005.6 | (5.0) |
| No collateral agreement | **1,008.0** | **137.2** | 1,049.8 | 165.8 |
| **Foreign exchange** | | | | |
| Bi-lateral collateral agreements | **425.7** | **(42.7)** | 440.4 | (11.7) |
| One way collateral agreements | **969.0** | **107.8** | 1,058.4 | 169.2 |
| No collateral agreement | **16.9** | **–** | 0.4 | – |
| | **17,881.0** | **(78.5)** | 18,485.1 | (81.0) |

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

# 1. Credit risk continued

## 1.4 Wholesale credit risk

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

As at 30 June 2015 the Bank had a £260m (2014: £297m) gross exposure to the Government of Finland. It held no other material non-UK sovereign debt (2014: £nil).

### 1.4.1 Direct exposures

During the period to 30 June 2015, exposures to financial institutions in European countries were broadly consistent with the year end with a total gross exposure outstanding at 30 June 2015 of £235m (2014: £274m).

Within the Treasury portfolio there are a number of risk mitigation techniques available including netting and collateralisation agreements. Other methods such as disposal and credit derivatives are used periodically to mitigate the credit risk associated with particular transactions.

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

The Treasury risk team reviews the portfolio and watchlists monthly for appropriate risk status bandings and any associated management actions. As at 30 June 2015 there were no red (highest risk) Eurozone exposures outstanding (2014: £nil).

### 1.4.2 Indirect exposures

Treasury risk management monitoring extends beyond direct risk incurred through counterparty trading to the underlying exposures which Treasury's counterparties may maintain on their own balance sheets. In analysing each counterparty's secondary exposure, we assess the vulnerability and impact on that counterparty should it suffer different degrees of losses.

Where secondary sovereign exposure or contagion risk is deemed to undermine the performance of the counterparty, remedial management actions are taken in respect of Treasury's counterparty limits and exposure.

Indirect sovereign exposure exists to the governments of France and Germany through government debt securities held as collateral against a series of currency swaps.

## 2. Liquidity Risk

Liquidity risk arises from mismatches in the timing of cash flows; such as maturities and withdrawals, new lending, and otherwise meeting contractual obligations.

The Bank is particularly exposed to any serious loss of confidence by its customers, as the majority of the Bank's funding consists of retail and commercial deposits. There is a risk that the availability of these deposits is reduced, or that the cost of replacing the deposits increases to unsustainable levels.

In the period to 30 June 2015 the Bank has increased its liquidity position, with a liquid asset ratio of 17.9% (2014: 17.4%). The Bank has proactively managed its liquidity position, maintaining a regulatory liquidity buffer, and has continued to restructure existing exposures to further improve the funding profile and ensure its financial obligations are met as and when they fall due.

### 2.1 Liquidity risk management framework

The Bank's liquidity risk management framework helps the Bank to manage its liquidity risk, the liquidity risk management framework covers the Bank's risk appetite to how liquidity risk is identified, measured, monitored, managed and reported. In addition to this, the Contingency Funding Plan (CFP) is maintained, detailing the procedures and a range of available actions that the Bank could take in the event of a liquidity or funding stress scenario.

The Board expresses its appetite for liquidity and funding risk in its Risk Appetite Statement.

The liquidity risk appetite is defined with reference to survival periods (which measures the ability of liquid assets and resources to support the Bank if it was to enter a defined stress scenario), adherence to strategic liquidity risk measures and compliance with all regulatory liquidity risk limits.

Within its risk appetite statement the Bank defines survival as ensuring that buffer liquidity never falls below the stressed regulatory minimum requirement. This is a higher benchmark than extinguishing all liquidity (insolvency) as the Board wishes to maintain regulatory confidence that the Bank can always meet its liabilities. The Bank analyses two applicable survival periods, one that envisages using contingent liquidity that provides sufficient time for the Bank to assess whether the franchise has altered considerably and further recovery options should be considered. The other survival period only uses liquid assets in ensuring that the Bank has time to raise additional liquidity by the contingency funding detailed within its CFP.

The framework for the liquidity risk appetite includes provision for a change in the stress scenario, selected from a range of options. The chosen scenario allows ALCO and the Board to most appropriately reflect the liquidity risks facing the Bank in the liquidity risk appetite. ALCO and the Board review the internal assessment of the Bank, and set the liquidity requirement for the following 12 month forecast horizon.

### 2.2 Liquidity risk policies

Liquidity risk policies are developed by the Liquidity and Market Risk Forum (LMRF), ALCO and the Board. The Bank's liquidity management policies are reviewed and approved annually by the BRC (on behalf of the Board) and compliance is reviewed by the LMRF, ALCO and the Board. The Bank's policy is to have sufficient funds available at all times to meet demands from depositors, to fund agreed advances, to meet other commitments as and when they fall due and to ensure the Board's risk appetite is met.

The Bank monitors its liquidity position on a daily basis via liquidity risk metrics. The LMRF oversees the operational liquidity management and convenes at least once a month. A range of indicators, details of cash flows and media coverage are monitored to attempt to detect early signs of liquidity stress either in the market or events that are specific to the Bank. The LMRF, ALCO and the Board discuss 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. In the event that the CFP is deployed following endorsement from ALCO, then the CEO will convene the Crisis Management Team (CMT) which will become the main management Committee that assumes responsibility for delivering the CFP, engaging other business areas of the Bank and third parties.

The liquidity position is reported at least monthly to ALCO and the Board. The Bank also monitors the adequacy of its controls to provide assurance that liquidity risk is being appropriately managed, and regularly assesses its funding position. The Bank's Liquidity Management Framework is designed in line with FCA and PRA BIPRU regulations and industry guidelines. This will further be updated to reflect the changing European regulation.

The Bank has implemented metrics to control the composition of liquidity resources, which is designed to manage the risk of concentrated cash flow maturities.

The strategic measures approved by the Board include:

- customer loan/deposit ratio, 95% (2014: 96%) – the ratio of customer loans to customer deposits;
- encumbrance ratio, 20% (2014: 27%) – the ratio of assets used in secured funding and long term repurchase agreements divided by total assets; and
- internal liquidity stress tests – the survival period of the Bank under an applicable stress scenario.

In the period to 30 June 2015, the Bank increased its liquid asset ratio to 17.9% at the balance sheet date (2014: 17.4%). This liquid asset ratio improvement is due to a reduction in total assets, this has yet to be offset by reduction in liabilities. The Bank continues to proactively manage its liquidity position above its own liquidity risk appetite.

All amounts are stated in £m unless otherwise indicated

# 2. Liquidity risk continued

## 2.3.1 Liquid asset portfolios

Total liquidity resources as at 30 June 2015 were £11,880.6m (2014: £12,120.4m). The table below analyses the Bank's liquidity portfolio by product and unencumbered liquidity value. Primary liquidity is liquid assets that are eligible under BIPRU 12.7 and total liquidity is all other liquid assets, including own issued retained securitisations (contingent liquidity portfolio).

| | **As at 30 June 2015** | As at 31 December 2014 |
|---|---|---|
| Operational balances with central banks | **4,045.1** | 4,487.4 |
| Gilts | **1,276.4** | 1,246.7 |
| Central government and multilateral development bank bonds | **765.5** | 819.5 |
| Total primary liquid assets | **6,087.0** | 6,553.6 |
| Other liquid assets | **492.6** | 14.3 |
| Contingent liquidity | **5,301.0** | 5,552.5 |
| Total liquidity | **11,880.6** | 12,120.4 |
| Average Balance | **11,256.2** | 12,015.8 |

The Bank uses any combination of these asset pools to manage liquidity, with primary liquidity used predominantly for short term cash flow movements, while other liquidity is used for creating longer term liquidity. Regular realisation through repo transactions and outright sales provide assurance that these asset pools remain sufficiently liquid. The overall quantum of total liquidity remained stable at approximately £12bn. The secondary liquidity portfolio includes own assets eligible for discounting at central banks, which has increased in 2015 and class A holdings in Warwick transactions. The remaining bonds are set out in the table below:

| | **As at 30 June 2015** | As at 31 December 2014 |
|---|---|---|
| Short term deposits | **–** | – |
| Other public sector securities | **–** | 2.5 |
| Floating rate notes | **30.5** | 31.0 |
| Fixed rate notes – Certificates of Deposit | **–** | – |
| Other securities and commodities | **93.3** | – |
| Total non-buffer assets | **123.8** | 33.5 |

## Wholesale funding

Wholesale funding is used to supplement retail and commercial deposits by raising longer term funds (over one year in duration) and to diversify the source of funds to support the business plan of the Bank. The Bank has a variety of long term wholesale funding sources outstanding, including securitisations, covered bond and euro medium-term notes, as shown in the table below:

| | **As at 30 June 2015** | As at 31 December 2014 |
|---|---|---|
| Preference shares, PSBs, and subordinated debt | **445.1** | 196.4 |
| Secured funding | **2,043.4** | 2,521.8 |
| Repos | **610.2** | 500.6 |
| Short term wholesale deposits | **11.4** | 46.0 |
| MTNs | **764.4** | 832.9 |
| Total wholesale funding | **3,874.5** | 4,097.7 |

The reduction of the wholesale funding reflects the repayment of a number of secured funding liabilities and raising of debt issuance in 2015.

The Bank has repo transactions of £610.2m which are secured by own issued retained securitisation notes, which are not recognised on the balance sheet.

All amounts are stated in £m unless otherwise indicated

## 2. Liquidity risk continued

The following table sets out the Bank's contractual wholesale funding by maturity:

| | **As at 30 June 2015** | As at 31 December 2014 |
|---|---|---|
| Repayable in less than 1 month | **449.1** | 84.8 |
| Repayable between 1 and 3 months | **–** | 324.1 |
| Repayable between 3 and 12 months | **532.5** | 389.8 |
| Repayable between 1 and 5 years | **652.5** | 580.8 |
| Repayable in more than 5 years | **2,240.4** | 2,718.2 |
| Total external funding | **3,874.5** | 4,097.7 |

The credit rating downgrades by the rating agencies in 2015 have led to sub-investment grade ratings being applied to the Bank's senior debt, leading to a reduction in potential primary and secondary demand for such unsecured instruments. This remains the case.

Since 2014 the Bank has third party back-up servicing and back-up cash management in place, and have made other changes into each of its covered bond and securitisation programmes to comply with rating agency criteria. The programme changes were effected through successful noteholder consent exercises and preserved the prevailing covered bond and securitisation programme note ratings. The current ratings of all securitisation programme notes remained unchanged since the previous half year.

### 2.4 Liquidity gap

Details of contractual maturities for assets and liabilities underpin the management of liquidity risk, however management recognises that customer behaviour differs to contractual maturity, therefore as part of the planning process, behavioural runoff of customer assets and liabilities over time are estimated. The assumptions used to create these estimates and the estimates themselves are approved by ALCO as part of its responsibility to approve the Bank's financial plans.

Gross cash flows include interest and other revenue cash flows. The following table is an analysis of gross undiscounted contractual cash flows of financial assets and liabilities held at the balance sheet date:

| **As at 30 June 2015 Contractual cash flows** | **Carrying value** | **Gross nominal flow** | **Less than 1 month** | **1–3 months** | **3–12 months** | **1–5 years** | **Over 5 years** |
|---|---|---|---|---|---|---|---|
| **Assets** | | | | | | | |
| Cash and balances at central banks | **4,577.7** | **4,577.7** | **4,577.7** | **–** | **–** | **–** | **–** |
| Loans and advances to banks | **934.3** | **934.3** | **556.1** | **378.2** | **–** | **–** | **–** |
| Loans and advances to customers[1] | **22,388.5** | **23,352.8** | **777.5** | **99.1** | **634.9** | **2,395.1** | **19,446.2** |
| Investment securities | | | | | | | |
| Loans and receivables | **18.0** | **15.6** | **–** | **–** | **–** | **–** | **15.6** |
| Available for sale | **3,698.9** | **3,594.0** | **–** | **273.0** | **278.9** | **1,209.6** | **1,832.5** |
| Fair value through income or expense | **1,065.0** | **1,134.9** | **1.8** | **41.9** | **16.0** | **1,033.9** | **41.3** |
| Derivative financial instruments | **347.0** | **658.6** | **5.6** | **10.0** | **55.1** | **290.5** | **297.4** |
| Other assets | **983.7** | **–** | **–** | **–** | **–** | **–** | **–** |
| **Total recognised assets** | **34,013.1** | **34,267.9** | **5,918.7** | **802.2** | **984.9** | **4,929.1** | **21,633.0** |
| **Liabilities** | | | | | | | |
| Deposits by banks | **714.7** | **682.0** | **490.9** | **16.9** | **174.2** | **–** | **–** |
| Customer accounts | **26,801.0** | **24,965.9** | **14,781.4** | **2,602.4** | **5,071.9** | **2,334.1** | **176.1** |
| Customer accounts – capital bonds | **142.4** | **142.3** | **11.0** | **26.2** | **62.8** | **42.3** | **–** |
| Debt securities in issue | **2,905.3** | **3,448.4** | **55.6** | **23.5** | **456.2** | **2,281.2** | **631.9** |
| Derivative financial instruments | **425.5** | **912.4** | **11.0** | **19.5** | **139.8** | **319.2** | **422.9** |
| Other borrowed funds | **446.4** | **755.3** | **3.6** | **7.8** | **33.2** | **175.9** | **534.8** |
| Other liabilities | **824.8** | **–** | **–** | **–** | **–** | **–** | **–** |
| **Total recognised liabilities** | **32,260.1** | **30,906.3** | **15,353.5** | **2,696.3** | **5,938.1** | **5,152.7** | **1,765.7** |
| Unrecognised loan commitments | **2,720.9** | **2,720.9** | **2,720.9** | **–** | **–** | **–** | **–** |
| **Total liabilities** | **34,981.0** | **33,627.2** | **18,074.4** | **2,696.3** | **5,938.1** | **5,152.7** | **1,765.7** |

1. Includes assets held for sale of £ 246.3m (31 December 2014 £323.4m) – see note 21 for further details.

All amounts are stated in £m unless otherwise indicated

## 2. Liquidity risk continued

| As at 31 December 2014 Contractual cash flows | Carrying value | Gross nominal flow | Less than 1 month | 1–3 months | 3–12 months | 1–5 years | Over 5 years |
|---|---|---|---|---|---|---|---|
| **Assets** | | | | | | | |
| Cash and balances at central banks | 4,765.3 | 4,765.3 | 4,765.3 | – | – | – | – |
| Loans and advances to banks | 1,608.4 | 1,608.4 | 1,238.4 | 370.0 | – | – | – |
| Loans and advances to customers | 25,849.3 | 33,816.8 | 947.2 | 308.6 | 1,520.9 | 8,193.7 | 22,846.4 |
| Investment securities | | | | | | | |
| Loans and receivables | 18.1 | 21.8 | – | – | 0.1 | 0.6 | 21.1 |
| Available for sale | 3,167.5 | 3,366.2 | 89.1 | 166.9 | 117.4 | 1,703.8 | 1,289.0 |
| Fair value through income or expense | 1,236.9 | 1,268.6 | 1.5 | 9.0 | 66.8 | 1,166.1 | 25.2 |
| Held for trading | – | – | – | – | – | – | – |
| Derivative financial instruments | 470.7 | 766.3 | 10.9 | 13.1 | 48.2 | 370.8 | 323.3 |
| Other assets | 466.7 | – | – | – | – | – | – |
| **Total recognised assets** | 37,582.9 | 45,613.4 | 7,052.4 | 867.6 | 1,753.4 | 11,435.0 | 24,505.0 |
| **Liabilities** | | | | | | | |
| Deposits by banks | 615.4 | 619.9 | 103.9 | 336.8 | 2.9 | 176.3 | – |
| Customer accounts | 29,614.0 | 29,974.1 | 19,117.1 | 933.6 | 7,130.5 | 2,606.2 | 186.7 |
| Customer accounts – capital bonds | 263.8 | 213.7 | 8.4 | 59.2 | 86.4 | 59.7 | – |
| Debt securities in issue | 3,443.6 | 4,379.3 | 94.2 | 745.3 | 478.5 | 2,400.8 | 660.5 |
| Derivative financial instruments | 551.7 | 1,088.4 | 14.1 | 26.4 | 123.5 | 390.4 | 534.0 |
| Other borrowed funds | 196.4 | 410.1 | 1.9 | 4.5 | 17.1 | 90.8 | 295.8 |
| Other liabilities | 883.5 | – | – | – | – | – | – |
| **Total recognised liabilities** | 35,568.4 | 36,685.5 | 19,339.6 | 2,105.8 | 7,838.9 | 5,724.2 | 1,677.0 |
| Unrecognised loan commitments | 3,017.5 | 3,017.5 | 2,872.6 | 85.3 | – | 59.6 | – |
| **Total liabilities** | 38,585.9 | 39,703.0 | 22,212.2 | 2,191.1 | 7,838.9 | 5,783.8 | 1,677.0 |

### 2.5 Encumbrance

An asset is defined as encumbered if it has been pledged as collateral against an existing liability or to collateralise an exposure that the Bank may have, restricting access to that asset in the event of resolution or bankruptcy. An encumbered asset would be no longer available to the Bank for use in secure funding, to satisfy collateral needs or to be sold to reduce the funding requirement.

| | Encumbered | Unencumbered | Total |
|---|---|---|---|
| Cash and other liquid assets | **783.2** | **3,794.5** | **4,577.7** |
| Investment securities | **1,870.3** | **2,911.6** | **4,781.9** |
| Loans | **4,073.2** | **19,249.6** | **23,322.8** |
| Other assets | **–** | **1,330.7** | **1,330.7** |
| | **6,726.7** | **27,286.4** | **34,013.1** |

# 3. Market risk

## 3.1 Overview

Market risk is the risk of loss as a result of the value of financial assets or liabilities (including off-balance sheet instruments) being adversely affected by movements in market rates or prices. This loss can be reflected in the near term earnings by changing net interest income, or in the longer term because of changes in the economic value of future cash flows.

The main source of market risk within the Bank is driven by mismatches between the repricing profiles of asset and liability customer products and certain characteristics embedded within these products and basis risk. The Bank no longer has a trading book although the Treasury function does create both market risk and currency risk through its various portfolio management activities.

## 3.2 Market risk management framework

Market risk is the responsibility of the Treasurer; delegated on a day-to-day basis to Asset and Liability Management (ALM) and Treasury Risk, who are responsible for monitoring current and emerging market risks, and for ensuring compliance with the Bank's market risk appetite. The Treasury Markets team is responsible for managing the Treasury portfolios and carrying out hedging activities to minimise interest rate risk exposure. Treasury ALM department ensures that the other interest rate risk in the banking book (IRRBB) is identified, modelled, reported, monitored and hedged effectively.

## 3.3 Market risk appetite

The Bank's primary objective is to minimise the sensitivity at product, balance or business level of net interest income and its economic value of its equity base to changes in interest rates. This is translated into a maximum amount of capital that the Bank deems necessary to hold to support the level of market risk exposure and the risk that those exposures may pose to the Bank's future financial performance.

The Bank assesses each of the market risk drivers and establishes a set of limits. In order to quantify the amount of capital the Bank requires against each source of market risk an internal assessment of a rate stress based on historical interest rate data is applied to the limit position. In this context the market risk appetite is expressed as an overarching amount of capital at risk. The overarching risk appetite is underpinned by a number of primary and secondary risk metrics. Primary risk metrics are set against each of the key drivers of market risk and adherence to these limits is central to maintaining market risk within overall appetite. Secondary risk metrics are also used which provide operational early warning indicators which may impact exposure which is assessed via primary risk metrics.

## 3.4 Primary risk metrics and sources of market risk

The key drivers of market risk that the Bank faces and the metrics used to manage those risks are:

### Interest rate risk

The primary risk metric employed by the Bank to manage directional interest rate risk and yield curve risk is the sensitivity of the Bank's net interest rate exposure to a one basis point parallel shift in interest rates (PV01). Limits are set at an overall level for directional interest rate risk and against individual time buckets for yield curve risk.

A key assumption within the calculation of the PV01 is the treatment of the non-interest bearing balances. The Bank periodically analyses its portfolio of non-interest bearing, non-maturity deposits in order to identify a stable 'core' element compared to the more volatile and transitory balances. A behavioural duration is applied to the former while the latter are assumed to reprice within one month. Similar assumptions are made for other non-interest bearing balance sheet items such as non-dated capital all of which are approved by the Bank's ALCO.

Risk limits are formally calculated at least monthly. Interest rate risk and effectiveness of hedging is monitored daily using gap positions, incorporating new business requirements. Draw down risk, in particular for fixed rate mortgages, is managed through weekly tranche meetings. The Treasury team undertakes hedges for interest rate risk using derivative instruments and investment securities to external wholesale markets.

### Basis risk

The definition of basis risk is the risk of loss as a result of the balance sheet being adversely affected by the movement between different index rates.

Basis risk is managed using an earnings at risk based metric, focusing in detail on the sensitivity of changes in interest rates on net interest income over a one year period. The assumed potential loss of earnings is based on historical rate movements and captures the period of stress which commenced in 2007. The estimated earnings at risk is then expressed as a percentage of the forecasted net interest income over the next twelve months.

Basis risk is monitored by BMRF and ALCO monthly with action taken as required.

## 3. Market risk continued

### Swap spread risk

Swap spread risk is defined as the risk between the fixed rate element of the swap agreement and the benchmarked treasury instrument that the organisation is exposed to.

The Bank manages swap spread risk by calculating on a daily basis the sensitivity of its hedged fixed rate bond portfolio to a one basis point divergence in yields between the fixed rate bond and its hedge (PV01).

### Foreign exchange risk

The Bank's exposure to foreign exchange risk is limited to customer hedging transactions and positions entered via natural customer flow only. Therefore, to manage this risk an overall maximum notional net sterling position limit is set for both intra-day and overnight exposures. This is supported by applying sub-limits to currencies by tier to reflect their liquidity.

### Other sources of market risk

- Directional risk – The sensitivity to the overall direction of interest rate movements;
- Yield Curve risk – The sensitivity to the relative movement of interest rates at different maturities on the yield curve;
- Prepayment risk – The risk that an asset or liability repays more quickly or slowly than anticipated resulting in a mismatch between the asset, liability and associated hedge;
- Pipeline risk – The risk that the sales profile for new fixed rate products do not match hedging assumptions, resulting in a mismatch between amount of product sold and that hedged, which can result in a hedge rebalancing cost;
- Explicit Option risk – The sensitivity to overall direction of interest rates, speed of change of interest rates and market prices for positions which contain explicit options e.g. caps, floors, swaptions;
- Repricing and Implicit Optionality in Products – The risk that options embedded or implied within retail or commercial products have an impact on market value or earnings with changing interest rates; and
- Credit Spread risk – The sensitivity to changes in the credit spread on wholesale assets.

The table illustrates the PV01, Basis risk, Swap spread and FX risk metrics on the Bank's balances. The PV01 is primarily driven by the non-sensitive balances offset by corresponding asset or derivative positions. The Basis risk is primarily driven by product mix and product pricing.

| | **As at 30 June 2015** | As at 31 December 2014 |
|---|---|---|
| Total PV01 (£k) | **(67.0)** | (141.4) |
| Average PV01 for the year (£k) | **(232.0)** | 17.6 |
| Maximum PV01 for the period | **(67.0)** | 167.8 |
| Minimum PV01 for the period | **(348.0)** | (141.4) |
| Average Basis Risk (% of annual NII) | **5.0%** | 4.4% |
| Swap Spread PV01 (£k) | **(887.0)** | (1,235.4) |
| Average of Swap Spread PV01 (£k) | **(1,109.0)** | (1,256.3) |
| FX Notional (£m) | **0.5** | (0.6) |
| Average FX Notional (£m) | **0.7** | (0.1) |

On 11 December 2014 the Bank signed a sale agreement committing to the disposal of £323m (base purchase price of £313m, which includes accrued interest) of Corporate assets. As part of this agreement the Bank also agreed to re-assign a number of derivatives linked to the assets within the agreement at a fixed price. As a result, the Bank unwound the opposing derivatives to protect its economic risk position. On completion of the transaction in 2015, the PV01 position would be +£73k as at June 2015.

## 3.5 Currency risk

The Bank's Treasury foreign exchange activities primarily involve:

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

All amounts are stated in £m unless otherwise indicated

## 3. Market risk continued

The table below provides an analysis of the Bank's assets and liabilities by currency in sterling equivalent terms:

| | As at 30 June 2015 | | | | | As at 31 December 2014 | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | **£** | **$** | **€** | **Other** | **Total** | £ | $ | € | Other | Total (as restated) |
| **Assets** | | | | | | | | | | |
| Cash and balances at central banks | **4,577.7** | **–** | **–** | **–** | **4,577.7** | 4,765.3 | – | – | – | 4,765.3 |
| Loans and advances to banks | **879.1** | **30.2** | **23.8** | **1.2** | **934.3** | 1,550.2 | 31.2 | 26.0 | 1.0 | 1,608.4 |
| Loans and advances to customers | **22,331.9** | **32.9** | **23.6** | **0.1** | **22,388.5** | 25,631.6 | 22.3 | 36.2 | 10.7 | 25,700.8 |
| Fair-value adjustments for hedged risk | **89.5** | **–** | **–** | **–** | **89.5** | 148.5 | – | – | – | 148.5 |
| Investment securities – loans and receivables | **18.0** | **–** | **–** | **–** | **18.0** | 18.1 | – | – | – | 18.1 |
| Investment securities – available-for-sale | **3,698.9** | **–** | **–** | **–** | **3,698.9** | 3,166.7 | 0.8 | | – | 3,167.5 |
| Investment securities – fair value through income or expense | **1,065.0** | **–** | **–** | **–** | **1,065.0** | 1,236.9 | – | – | – | 1,236.9 |
| Derivative financial instruments | **347.2** | **(0.1)** | **(0.1)** | **–** | **347.0** | 470.7 | – | – | – | 470.7 |
| Investments in joint ventures | **5.2** | **–** | **–** | **–** | **5.2** | 5.3 | – | – | – | 5.3 |
| Equity shares | **2.6** | **–** | **–** | **–** | **2.6** | 2.8 | – | – | – | 2.8 |
| Intangible fixed assets | **113.7** | **–** | **–** | **–** | **113.7** | 103.7 | – | – | – | 103.7 |
| Investment properties | **2.1** | **–** | **–** | **–** | **2.1** | 2.1 | – | – | – | 2.1 |
| Property, plant and equipment | **53.6** | **–** | **–** | **–** | **53.6** | 67.5 | – | – | – | 67.5 |
| Deferred tax assets | **16.9** | **–** | **–** | **–** | **16.9** | 21.0 | – | – | – | 21.0 |
| Other assets | **422.3** | **–** | **–** | **–** | **422.3** | 187.3 | – | 0.3 | – | 187.6 |
| Amounts owed by other group undertakings | **–** | **–** | **–** | **–** | **–** | – | – | – | – | – |
| Prepayments and accrued income | **16.7** | **–** | **–** | **–** | **16.7** | 12.2 | – | – | – | 12.2 |
| Current tax assets | **0.1** | **–** | **–** | **–** | **0.1** | 0.6 | – | – | – | 0.6 |
| Assets held for sale | **261.0** | **–** | **–** | **–** | **261.0** | 63.9 | – | – | – | 63.9 |
| **Total assets** | **33,901.5** | **63.0** | **47.3** | **1.3** | **34,013.1** | 37,454.4 | 54.3 | 62.5 | 11.7 | 37,582.9 |
| **Liabilities** | | | | | | | | | | |
| Deposits by banks | **705.5** | **–** | **9.2** | **–** | **714.7** | 601.0 | – | 14.4 | – | 615.4 |
| Customer accounts | **26,758.8** | **15.3** | **25.9** | **1.0** | **26,801.0** | 29,571.2 | 16.8 | 25.0 | 1.0 | 29,614.0 |
| Customer accounts – capital bonds | **142.4** | **–** | **–** | **–** | **142.4** | 263.8 | – | – | – | 263.8 |
| Debt securities in issue | **1,838.6** | **574.1** | **492.6** | **–** | **2,905.3** | 1,809.5 | 603.2 | 1,030.9 | – | 3,443.6 |
| Derivative financial instruments | **425.5** | **–** | **–** | **–** | **425.5** | 550.5 | – | 1.2 | – | 551.7 |
| Other borrowed funds | **446.4** | **–** | **–** | **–** | **446.4** | 196.4 | – | – | – | 196.4 |
| Amounts owed to other group undertakings | **–** | **–** | **–** | **–** | **–** | – | – | – | – | – |
| Other liabilities | **163.5** | **2.0** | **–** | **–** | **165.5** | 157.8 | – | – | – | 157.8 |
| Accruals and deferred income | **33.5** | **–** | **–** | **–** | **33.5** | 16.0 | – | – | – | 16.0 |
| Provisions for liabilities and charges | **552.0** | **–** | **–** | **–** | **552.0** | 617.5 | – | – | – | 617.5 |
| Current tax liabilities | **0.3** | **–** | **–** | **–** | **0.3** | 0.3 | – | – | – | 0.3 |
| Deferred tax liabilities | **72.5** | **–** | **–** | **–** | **72.5** | 84.0 | – | – | – | 84.0 |
| Liabilities held for sale | **1.0** | **–** | **–** | **–** | **1.0** | 7.9 | – | – | – | 7.9 |
| **Total liabilities** | **31,140.0** | **591.4** | **527.7** | **1.0** | **32,260.1** | 33,875.9 | 620.0 | 1,071.5 | 1.0 | 35,568.4 |
| **Net on-balance sheet position** | **2,761.5** | **(528.4)** | **(480.4)** | **0.3** | **1,753.0** | 3,578.5 | (565.7) | (1,009.0) | 10.7 | 2,014.5 |

# 4. Capital management

Capital is held by the Bank to protect its depositors, to cover its inherent risks, to provide a cushion for unexpected losses and to support the development of the business.

The Bank manages and calculates its capital in accordance with CRD IV, which includes the Capital Requirements Regulation (CRR) and Capital Requirements Directive (CRD). The European Banking Authority is providing technical standards relating to CRD IV some of which are not yet finalised. CRD IV disclosures in this document are based on the Bank's interpretation of published rules.

All CRD IV disclosures are shown on a transitional and fully loaded basis except for the leverage ratio which is only calculated on a fully loaded basis. Through its Policy Statement PS7/13, the PRA has implemented Common Equity Tier 1 ("CET1") deductions and prudential filters in full. The Bank's fully loaded and transitional positions for additional Tier 1 and Tier 2 capital are similar; however, minority interests retain a transitional element.

During the year 2015 the Bank closed its inaugural whole structure securitisation of part of its Non-core Optimum residential mortgages portfolio through the issuance of notes and residual certificates by Warwick Finance Residential Mortgages Number One PLC ("Warwick Finance One").

Warwick Finance One comprises a portfolio of £1.5bn residential mortgages (with a cut-off date of 20 April 2015) issuing rated RMBS and residual certificates to investors. The transaction satisfies significant risk transfer requirements under CRR in relation to the securitised portfolio. In addition the Bank will retain 65% of the Class A Notes on settlement. The Class A Note retention is the only position retained by the Bank within the Warwick Finance One capital structure, and enables the Bank to meet CRR retention requirements for originators of securitisations.

The Warwick Finance One transaction's pro forma impact would have increased the Bank's 31 December 2014 CET1 capital position by approximately 0.9%, from 13.0% to 13.9%. The successful closing of this transaction forms a key component of the Bank's plan to accelerate the de-leveraging of its non-core assets, including Optimum.

- Fully-loaded Common Equity Tier 1 ratio has increased to 14.9% as at 30 June 2015 (31 December 2014: 13.0%) with a decrease in Common Equity Tier 1 of £138.0m more than offset by a decrease in risk weighted assets of £2.5bn.
- Fully-loaded leverage ratio is broadly stable at 4.3% as at 30 June 2015 (31 December 2014: 4.2%) reflecting a decrease in Tier 1 of £138.2m and a decrease in exposure of £3.7bn.
- At 30 June 2015, the Bank was compliant with its Individual Capital Guidance (ICG), being the PRA's statement as to the regulatory capital it expects the Bank to hold. However due to the Bank's ongoing losses, this position should be regarded as a very temporary situation. The Bank met the Pillar 1 requirement throughout the period.
- The Bank's capital plan, which has been accepted by the PRA, anticipates that the Bank will meet the 7% CET1 ratio throughout the planning period and will have sustainably met ICG by the latter part of the planning period. The plan aims to build a sustainable Core Bank and is designed to create a capital buffer by 2019 which would withstand a severe stress scenario, equivalent to 2014 Bank of England stress test. The Bank's leverage ratio is expected to be sustainably above 3.0% by the end of the planning period.

## Risks

The Bank faces risks that may adversely impact the ability of the Bank to comply with its regulatory capital requirements, these include:

- Worsening economic and market conditions and/or increasing interest rates and/or a fall in house prices could result in the Core and Non-core assets suffering from more than expected impairments which would adversely impact on the Bank's operating results and retained earnings;
- The Bank needs the ongoing acceptance of the PRA regarding projected ICG deficit in moving forwards with its plan. To the extent this is not forthcoming or to the extent that the Bank does not perform in line with its plan, additional capital may be required over and above that included in the plan in order for the Bank to remain a Going Concern. This could also be the case if there are increases in regulatory capital requirements as a result of changes to international regulations or other changes to legislation or other market wide regulatory requirements or a change in regulatory risk appetite. The plan assumes additional non-CET1 capital will be raised within the plan period;
- The inability of the Bank to deleverage its Non-core assets in a controlled and capital efficient manner may have a negative impact on the Bank's operating results and financial position and its regulatory capital position. In addition, any greater than expected costs or delays in deleveraging the Non-core assets may divert funding from and adversely impact the longer term development and growth of the Core business; and
- Inability of the Bank for whatever reason to execute on its plan.

For more information on the risks facing the Bank see Principal Risks and Uncertainties section and note 1.

### Capital Stress Testing

The Bank uses stress testing as part of its assessment of capital adequacy, and includes stress testing in relation to:

- Financial Plan;
- ICAAP; and
- Annual stress testing exercise.

Stress testing is embedded within the Bank's financial planning process, with stressed scenarios applied to the Bank's base case plan, at least on an annual basis or more frequent where required. This enables the Bank's senior management and Board to assess the plan under adverse scenarios to ensure the plan remains within risk appetite or that appropriate strategic decisions can be taken.

All amounts are stated in £m unless otherwise indicated

## 4. Capital management continued

Scenarios capture a magnitude of macroeconomic variables including GDP, interest rates, unemployment, house prices and commercial real estate prices. An example scenario includes Euro sovereign debt concerns and weakening global economic activity, causing UK exports to recede. The Bank also performs stress testing against PRA defined anchor scenarios, as well as its own bespoke scenarios.

Individual business areas prepare business plans as part of the financial planning process. Stress testing models are utilised to stress businesses' plans over a forward looking five year planning horizon.

Stress testing results are prepared on both a pre and post management action basis, and compared to both risk appetite and minimum regulatory requirements. Review and challenge of stress testing results are undertaken by the business and the second line of defence, with review through the Bank's Committee structure.

The Bank also undertakes reverse stress testing to assess the point at which the Bank is likely to fail, on both an individual and combined event basis.

The Co-operative Bank plc was a participant in the Bank of England 2014 UK concurrent stress test of the eight major UK banks and building societies. This was designed specifically to assess resilience to a very severe housing market shock and to a sharp rise or snap back in interest rates. This was not a forecast or expectation by the Bank of England regarding the likelihood of a set of events materialising, but a coherent, severe 'tail risk' scenario.

Results of this exercise were published on 16 December 2014 and can be found on the Bank of England website www.bankofengland.co.uk.

As a result of the stress test, the Bank was required to submit a revised capital plan which was accepted by the PRA in December 2014. This plan is designed to enable the Bank to withstand a severe stress by 2019. The Bank does not expect to be able to withstand a severe stress before this date. As part of the plan, the Bank has committed to reducing its risk weighted assets to £7.5bn by the end of 2018, and will primarily undertake this through continued reduction of the Optimum portfolio which is particularly vulnerable to stress.

### Capital resources CRD IV

| | As at 30 June 2015 | | As at 31 December 2014 | |
|---|---|---|---|---|
| | **Transitional** | **Fully-loaded** | Transitional | Fully-loaded |
| **Common Equity Tier 1 (CET1) capital: instruments and reserves** | | | | |
| Permanent share capital and the related share premium account | **1,759.5** | **1,759.5** | 1,759.5 | 1,759.5 |
| Retained earnings | **(273.1)** | **(273.1)** | (36.7) | (36.7) |
| Available for sale and cash flow hedge reserves | **55.2** | **55.2** | 83.6 | 83.6 |
| Minority Interests[3] | **6.6** | **6.6** | 6.1 | 10.6 |
| Independently reviewed interim profits net of any foreseeable charge or dividend | **–** | **–** | – | – |
| Other Reserves[2] | **410.0** | **410.0** | 410.0 | 410.0 |
| **CET1 capital before regulatory adjustments** | **1,958.2** | **1,958.2** | 2,222.5 | 2,227.0 |
| | | | | |
| **CET1 capital: regulatory adjustments** | | | | |
| Prudential valuation in trading book | **(2.6)** | **(2.6)** | (0.4) | (0.4) |
| Intangible assets (net of related tax liability) | **(113.7)** | **(113.7)** | (103.7) | (103.7) |
| Deferred tax assets not arising from temporary differences | **–** | **–** | – | – |
| Cash flow hedge reserves | **(38.0)** | **(38.0)** | (59.0) | (59.0) |
| Expected loss shortfall | **(72.6)** | **(72.6)** | (191.5) | (191.5) |
| Securitisation positions treated as deduction | **–** | **–** | – | – |
| Losses for the year[1] | **(233.3)** | **(233.3)** | (236.4) | (236.4) |
| Filter for unrealised gains on debt instruments held in the available for sale category | **–** | **–** | – | – |
| Unrealised gains or losses on available for sale assets (revaluation reserve) | **–** | **–** | (24.6) | – |
| Qualifying AT1 deductions that exceed AT1 capital | **–** | **–** | – | – |
| **Total regulatory adjustments to CET1** | **(460.2)** | **(460.2)** | (615.6) | (591.0) |
| **CET1 capital** | **1,498.0** | **1,498.0** | 1,606.9 | 1,636.0 |
| **Additional Tier 1 (AT1) capital: instruments** | | | | |
| Perpetual non-cumulative preference shares | **–** | **–** | – | – |
| Minority Interests[3] | **17.3** | **2.1** | 22.9 | 2.3 |

All amounts are stated in £m unless otherwise indicated

## 4. Capital management continued

| | As at 30 June 2015 | | As at 31 December 2014 | |
|---|---|---|---|---|
| | **Transitional** | **Fully-loaded** | Transitional | Fully-loaded |
| **AT1 capital before regulatory adjustments** | **17.3** | **2.1** | 22.9 | 2.3 |
| **AT1 capital: regulatory adjustments** | | | | |
| Intangible assets | **–** | **–** | – | – |
| Expected loss shortfall (half) | **–** | **–** | – | – |
| **Total regulatory adjustments to AT1 capital** | **–** | **–** | – | – |
| AT1 adjustments in excess of AT1 capital | **–** | **–** | – | – |
| **AT1 capital** | **17.3** | **2.1** | 22.9 | 2.3 |
| | | | | |
| **Tier 1 capital (T1 = CET1 + AT1)** | **1,515.3** | **1,500.1** | 1,629.8 | 1,638.3 |
| | | | | |
| **Tier 2 (T2) capital: instruments and provisions** | | | | |
| Capital instruments | **197.1** | **197.1** | 196.4 | 196.4 |
| Minority Interests[3] | **1.0** | **2.5** | 0.8 | 3.0 |
| Credit risk adjustments[1] | **18.8** | **18.8** | 52.2 | 52.2 |
| **T2 capital before regulatory adjustments** | **216.9** | **218.4** | 249.4 | 251.6 |
| | | | | |
| T2 capital: regulatory adjustments | | | | |
| Revaluation reserves | **–** | **–** | – | – |
| **Total regulatory adjustments to T2 capital** | **–** | **–** | – | – |
| **T2 capital** | **216.9** | **218.4** | 249.4 | 251.6 |
| | | | | |
| **Total capital (TC = T1 + T2)** | **1,732.2** | **1,718.5** | 1,879.2 | 1,889.9 |

1. A reconciliation of statutory to regulatory loss for the year is included on page 57.
2. Other reserves includes the £410m capital redemption reserve created as a result of the Bank's Liability Management Exercise in 2013.
3. Minority interest represents the share of the capital and reserves of Unity Trust Bank that is attributable to third party investors. Under CRD IV the amount of minority interest which can be recognised by the Bank is allocated between the different tiers of capital.

All amounts are stated in £m unless otherwise indicated

## 4. Capital management continued

### Capital ratios and Risk Weighted Assets

| | 30 June 2015 | | 31 December 2014 | |
|---|---|---|---|---|
| | **Transitional** | **Fully-loaded** | Transitional | Fully-loaded |
| **Capital ratios** | | | | |
| Common Equity Tier 1 ratio | **14.9%** | **14.9%** | 12.7% | 13.0% |
| Tier 1 ratio | **15.0%** | **14.9%** | 12.9% | 13.0% |
| **Total capital ratio** | **17.2%** | **17.1%** | 14.9% | 15.0% |
| | | | | |
| **Risk weighted assets** | | | | |
| Credit risk | **9,170.5** | **9,170.5** | 11,500.4 | 11,500.4 |
| Market risk | **–** | **–** | – | – |
| Operational risk | **905.3** | **905.3** | 1,131.8 | 1,131.8 |
| **Total risk weighted assets** | **10,075.8** | **10,075.8** | 12,632.2 | 12,632.2 |
| | | | | |
| **Segmental analysis of credit risk risk-weighted assets** | | | | |
| Core | | | | |
| Retail | **1,858.6** | **1,858.6** | 1,866.6 | 1,866.6 |
| BaCB | **674.1** | **674.1** | 760.0 | 760.0 |
| Treasury/other | **1,413.1** | **1,413.1** | 1,723.8 | 1,723.8 |
| **Total Core** | **3,945.8** | **3,945.8** | 4,350.4 | 4,350.4 |
| **Non-core** | | | | |
| Corporate CoAM | **2,595.9** | **2,595.9** | 3,624.0 | 3,624.0 |
| Optimum | **2,628.8** | **2,628.8** | 3,526.0 | 3,526.0 |
| Illius | **–** | **–** | – | – |
| **Total Non-core** | **5,224.7** | **5,224.7** | 7,150.0 | 7,150.0 |
| **Total credit risk risk-weighted assets** | **9,170.5** | **9,170.5** | 11,500.4 | 11,500.4 |

Fully-loaded CET1 ratio has increased to 14.9% from 13.0% as at 31 December 2014. This reflects a decrease in CET1 of £138.0m and a decrease in risk weighted assets of £2.5bn.

The decrease in CET1 reflects a £233.1m regulatory loss for the year, partially offset by a £118.9m reduction in the CET1 deduction for expected loss shortfall. The reduction in expected loss shortfall is driven by a change in methodology to reflect European Banking Authority (EBA) guidance which allows netting of expected loss shortfall for exposures in default. The Bank previously calculated expected loss shortfall on an individual customer basis for exposures in default with no netting applied between customers. The calculation of expected loss shortfall is still calculated separately for defaulted and non-defaulted exposures as per CRR and EBA requirements.

The £0.8bn RWA reduction within the Non-Core Optimum portfolio is primarily driven by the securitisation of £1.5bn residential mortgages in May 2015. The £1.0bn RWA reduction in Corporate CoAM is driven by ongoing asset sales and deleveraging activity of the Non-core business. Please refer to the detailed financial review section for further information.

Operational risk RWAs have decreased by £227m following the annual recalculation of the Pillar 1 operational risk requirement following the 2014 year end results.

The Bank successfully raised £250m of Tier 2 capital on 30 June 2015 which will help the Bank comply with minimum capital regulatory requirements and expectations. However, payment for this capital was not received until 1 July 2015, therefore in order to ensure compliance with CRR requirements for capital instruments to be fully paid up; the capital issuance has not been recognised within the Bank's capital resources until July 2015. If the issuance was included within June capital resources, the Bank's total capital ratio would have been 19.5%.

All amounts are stated in £m unless otherwise indicated

# 4. Capital management continued

## Reconciliation of equity per balance sheet to total capital

| Balance sheet presentation | Balance per accounts | Regulatory presentation | Regulatory balance per accounts | Cashflow hedge reserve | Minority interests | Sub-debt not Fully Paid Up | Deferred tax assets that are risk weighted | EL | Prudent valuation in trading book | Capital resources transitional rules |
|---|---|---|---|---|---|---|---|---|---|---|
| **Equity** | | | | | | | | | | |
| Ordinary share capital | **22.6** | Paid up capital instruments | **22.6** | – | – | – | – | – | – | **22.6** |
| Share premium account | **1,736.9** | Share premium | **1,736.9** | – | – | – | – | – | – | **1,736.9** |
| Retained earnings | **(506.4)** | Retained earnings | **(273.1)** | – | – | – | – | – | – | **(273.1)** |
| | – | Regulatory losses for the period | **(233.3)** | – | – | – | – | – | – | **(233.3)** |
| Available for sale reserve | **17.2** | Available for sale reserve | **17.2** | – | – | – | – | – | – | **17.2** |
| Cashflow hedging reserve | **38.0** | Cashflow hedging reserve | **38.0** | **(38.0)** | – | – | – | – | – | – |
| Capital redemption reserve | **410.0** | Other reserves | **410.0** | – | – | – | – | – | – | **410.0** |
| Non-controlling interests | **34.7** | Minority interest | **34.7** | – | **(9.8)** | – | – | – | – | **24.9** |
| **Total equity** | **1,753.0** | | **1,753.0** | **(38.0)** | **(9.8)** | – | – | – | – | **1,705.2** |
| **Non-equity** | | | | | | | | | | |
| Other borrowed funds | **446.4** | Tier 2 Capital instruments | **446.4** | – | – | **(249.3)** | – | – | – | **197.1** |
| Intangible assets | **(113.7)** | Intangible assets (net of related tax liability) | **(113.7)** | – | – | – | – | – | – | **(113.7)** |
| Deferred tax assets | **16.9** | Deferred tax assets not arising from temporary differences | **16.9** | – | – | – | **(16.9)** | – | – | – |
| Impairment[1] | **523.4** | Expected loss shortfall | **59.8** | – | – | – | – | **(132.4)** | – | **(72.6)** |
| | – | Expected loss Tier 2 add-back | **463.6** | – | – | – | – | **(444.8)** | – | **18.8** |
| | – | Prudent valuation in trading book | – | – | – | – | – | – | **(2.6)** | **(2.6)** |
| **Total non-equity** | **873.0** | | **873.0** | – | – | **(249.3)** | **(16.9)** | **(577.2)** | **(2.6)** | **27.0** |
| **Total balances subject to own funds calculations** | **2,626.0** | **Total balances subject to own funds calculations** | **2,626.0** | **(38.0)** | **(9.8)** | **(249.3)** | **(16.9)** | **(577.2)** | **(2.6)** | **1,732.2** |

1. Impairment is included within loans and advances to customers within the statutory balance sheet. Only impairment relating to exposures calculated under the IRB approach to credit risk are applicable for the calculation of Expected loss shortfall. Therefore the impairment number included in the table above relates to IRB exposures only, and is a subset of the Bank's total impairment.

## Reconciliation of statutory to regulatory loss for the period

| | Period to 30 June 2015 |
|---|---|
| Statutory loss for the period | **(233.1)** |
| Statutory loss attributable to minority shareholders | **(0.2)** |
| Discounted cash flows for ordinary shares not recognised until cash consideration paid | – |
| **Regulatory loss for the period** | **(233.3)** |

All amounts are stated in £m unless otherwise indicated

## 4. Capital management continued

### Fully Loaded Leverage Ratio

| | As at 30 June 2015 | Restated As at 31 December 2014[1] |
|---|---|---|
| Derivative exposures | **393.6** | 509.1 |
| Securities financing transactions (SFTs) | **113.7** | 190.5 |
| Other assets | **33,894.5** | 37,557.3 |
| Off-balance sheet items | **1,003.4** | 957.0 |
| Regulatory deductions and other adjustments | **(227.0)** | (354.6) |
| **Total fully loaded leverage exposure** | **35,178.2** | 38,859.3 |
| | | |
| **Fully-loaded CRD IV tier 1 capital** | **1,500.1** | 1,638.3 |
| | | |
| **Fully loaded leverage ratio** | **4.3%** | 4.2% |

1. The leverage ratio has been calculated using the exposure basis within the European Commission delegated act.

The fully-loaded leverage ratio is broadly stable with a 0.1% increase to 4.3% as at 30 June 2015 (31 December 2014: 4.2%). The leverage ratio is calculated as Tier 1 capital divided by adjusted balance sheet exposures. The ratio reflects a £138.2m decrease in total Tier 1 capital which is offset by the impact of a £3.7bn decrease in regulatory leverage exposure as a result of securitisation of the Optimum portfolio and reflecting the Bank's overall deleveraging strategy.

Along with the CET1 ratio, the leverage ratio is expected to worsen during the plan period, before subsequently recovering towards the end of the plan period. It is expected to be sustainably above 3% towards the end of the plan period.

# Independent review report to The Co-operative Bank plc

## Introduction

We have been engaged by the Bank to review the condensed set of financial statements in the Interim Financial Report for the six months ended 30 June 2015 which comprises the Bank income statement, the Bank statement of comprehensive income, the Bank balance sheet, the Bank statement of cash flows, the Bank statement of changes in equity and the related explanatory notes 1 to 23. We have read the other information contained in the Interim Financial Report and considered whether it contains any apparent misstatements or material inconsistencies with the information in the condensed set of financial statements.

This report is made solely to the Bank in accordance with guidance contained in International Standard on Review Engagements 2410 (UK and Ireland) 'Review of Interim Financial Information Performed by the Independent Auditor of the Entity' issued by the Auditing Practices Board. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Bank, for our work, for this report, or for the conclusions we have formed.

## Directors' Responsibilities

The Interim Financial Report is the responsibility of, and has been approved by, the Directors. The Directors are responsible for preparing the Interim Financial Report in accordance with the Disclosure and Transparency Rules of the United Kingdom's Financial Conduct Authority.

As disclosed in note 1, the annual financial statements of the Bank are prepared in accordance with IFRSs as adopted by the European Union. The condensed set of financial statements included in this Interim Financial Report has been prepared in accordance with International Accounting Standard 34, 'Interim Financial Reporting', as adopted by the European Union.

## Our Responsibility

Our responsibility is to express to the Bank a conclusion on the condensed set of financial statements in the Interim Financial Report based on our review.

## Scope of Review

We conducted our review in accordance with International Standard on Review Engagements (UK and Ireland) 2410, 'Review of Interim Financial Information Performed by the Independent Auditor of the Entity' issued by the Auditing Practices Board for use in the United Kingdom. A review of interim financial information consists of making enquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with International Standards on Auditing (UK and Ireland) and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

## Conclusion

Based on our review, nothing has come to our attention that causes us to believe that the condensed set of financial statements in the Interim Financial Report for the six months ended 30 June 2015 is not prepared, in all material respects, in accordance with International Accounting Standard 34 as adopted by the European Union and the Disclosure and Transparency Rules of the United Kingdom's Financial Conduct Authority.

## Emphasis of matter – Going concern

In forming our conclusion on the Interim Financial Report, which is unmodified, we have considered the adequacy of the disclosures made in note 1.3 to the Interim Financial Report concerning the Bank's ability to continue as a going concern. In that section, the directors set out the risks associated with the successful execution of the Bank's 2015-2019 Strategic Plan. The matters explained in note 1.3 to the Interim Financial Report represent a material uncertainty which may cast significant doubt upon the Bank's ability to continue as a going concern. The condensed set of financial statements does not include the adjustments that would result if the Bank was unable to continue as a going concern.

**Ernst & Young LLP**
London, United Kingdom

Date: 19 August 2015

# The Bank Interim Financial Report

# The Bank income statement

## For the period ended 30 June 2015 (unaudited)

All amounts are stated in £m unless otherwise indicated

| | Note | Period to 30 June 2015 | Restated Period to 30 June 2014 |
|---|---|---|---|
| Interest receivable and similar income | 5 | **415.7** | 538.6 |
| Interest expense and similar charges | 5 | **(253.8)** | (363.4) |
| **Net interest income** | | **161.9** | 175.2 |
| | | | |
| Fee and commission income | 6 | **64.3** | 104.9 |
| Fee and commission expense | 6 | **(16.6)** | (36.9) |
| **Net fee and commission income** | | **47.7** | 68.0 |
| | | | |
| Net trading income | | **–** | 0.2 |
| Other operating income/(expense) | 7 | **(44.8)** | (4.1) |
| **Operating income** | | **164.8** | 239.3 |
| | | | |
| **Operating expenses** | | | |
| Operating expenses | 8 | **(385.1)** | (393.3) |
| Provision for customer redress | | **(28.5)** | (9.6) |
| **Total operating expenses** | | **(413.6)** | (402.9) |
| **Operating losses before impairment losses** | | **(248.8)** | (163.6) |
| Impairment gains on loans and advances | 11 | **44.6** | 86.7 |
| **Operating loss** | | **(204.2)** | (76.9) |
| Share of post-tax losses from joint ventures | | **–** | (0.1) |
| **Loss before taxation** | | **(204.2)** | (77.0) |
| Income tax | 10 | **(28.9)** | 12.3 |
| **Loss for the financial period** | | **(233.1)** | (64.7) |
| | | | |
| Attributable to: | | | |
| Equity shareholders | | **(233.3)** | (65.6) |
| Non-controlling interests | | **0.2** | 0.9 |
| | | **(233.1)** | (64.7) |
| **Loss per share (basic and fully diluted)** | | **(51.67)p** | (23.18)p |

As discussed in the 2014 Annual Report and Accounts, as the Bank is not legally entitled to interest income and similar income in respect of customers affected by certain breaches of the technical requirements of the Consumer Credit Act (CCA), this line item has been represented. In the period to 30 June 2014, £4.0m, £5.0m and £8.6m included within interest income, fee and commission expense and operating expenses respectively have been aggregated and disclosed separately on the face of the Income Statement.

The 2014 comparatives have been restated as described in note 3.

In total £49.0m (30 June 2014: £38.6m) of conduct and legal provisions have been incurred during the period. This includes £20.0m (2014 restated: £29.0m) reported within interest receivable and similar income, £nil (2014 restated: £nil) reported within fee and commission income, £0.5m (2014 restated: £nil) reported within operating expenses and £28.5m (2014 restated: £9.6m) within the provision for customer redress line. Further details can be found in note 14.

The notes on pages 67 to 111 form part of these financial statements.

# The Bank statement of comprehensive income

## For the period ended 30 June 2015 (unaudited)

All amounts are stated in £m unless otherwise indicated

| | **Period from 1 Jan 2015 to 30 June 2015** | | | Restated Period from 1 Jan 2014 to 30 June 2014 | | |
|---|---|---|---|---|---|---|
| | **Equity shareholders** | **Non-controlling interests** | **Total** | Equity shareholders | Non-controlling interests | Total |
| (Loss)/Profit for the period | **(233.3)** | **0.2** | **(233.1)** | (65.6) | 0.9 | (64.7) |
| | | | | | | |
| **Other comprehensive (expense)/income that may be recycled to profit and loss:** | | | | | | |
| Changes in cash flow hedges | | | | | | |
| Net changes in fair value recognised directly in equity | **(17.0)** | | **(17.0)** | (4.1) | (0.3) | (4.4) |
| Income tax | **1.8** | **–** | **1.8** | 2.6 | – | 2.6 |
| Transfers from equity to income or expense | **(6.4)** | **–** | **(6.4)** | (5.3) | – | (5.3) |
| Income tax | **0.6** | **–** | **0.6** | (0.3) | – | (0.3) |
| | | | | | | |
| Changes in available for sale assets | | | | | | |
| Net changes in fair value recognised directly in equity | **(12.3)** | **–** | **(12.3)** | 18.0 | – | 18.0 |
| Income tax | **4.9** | **–** | **4.9** | (3.9) | – | (3.9) |
| Transfers from equity to income or expense | **–** | **–** | **–** | (12.4) | – | (12.4) |
| Income tax | **–** | **–** | **–** | 2.7 | – | 2.7 |
| | | | | | | |
| Other comprehensive (expense)/income for the financial period, net of income tax | **(28.4)** | **–** | **(28.4)** | (2.7) | (0.3) | (3.0) |
| **Total comprehensive (expense)/income for the financial period** | **(261.7)** | **0.2** | **(261.5)** | (68.3) | 0.6 | (67.7) |

The 2014 comparatives have been restated as described in note 3.

The notes on pages 67 to 111 form part of these financial statements.

# The Bank balance sheet

## At 30 June 2015 (unaudited)

All amounts are stated in £m unless otherwise indicated

| | Note | As at 30 June 2015 | As at 31 December 2014 |
|---|---|---|---|
| **Assets** | | | |
| Cash and balances at central banks | | **4,577.7** | 4,765.3 |
| Loans and advances to banks | | **934.3** | 1,608.4 |
| Loans and advances to customers | 11a | **22,388.5** | 25,377.4 |
| Fair value adjustments for hedged risk | 11b | **89.5** | 148.5 |
| Investment securities – loans and receivables | 12a | **18.0** | 18.1 |
| Investment securities – available for sale | 12b | **3,698.9** | 3,167.5 |
| Investment securities – fair value through income or expense | 12c | **1,065.0** | 1,236.9 |
| Derivative financial instruments | | **347.0** | 470.7 |
| Non-current assets classified as held for sale | | **261.0** | 387.3 |
| Equity shares | | **2.6** | 2.8 |
| Investments in joint ventures | | **5.2** | 5.3 |
| Investment properties | | **2.1** | 2.1 |
| Property, plant and equipment | | **53.6** | 67.5 |
| Intangible assets | | **113.7** | 103.7 |
| Other assets | | **422.3** | 187.6 |
| Prepayments and accrued income | | **16.7** | 12.2 |
| Current tax assets | | **0.1** | 0.6 |
| Deferred tax assets | 15 | **16.9** | 21.0 |
| **Total assets** | | **34,013.1** | 37,582.9 |
| **Liabilities** | | | |
| Deposits by banks | | **714.7** | 615.4 |
| Customer accounts | | **26,801.0** | 29,614.0 |
| Customer accounts – capital bonds | 13 | **142.4** | 263.8 |
| Debt securities in issue | | **2,905.3** | 3,443.6 |
| Derivative financial instruments | | **425.5** | 551.7 |
| Other borrowed funds | | **446.4** | 196.4 |
| Other liabilities | | **165.5** | 157.8 |
| Accruals and deferred income | | **33.5** | 16.0 |
| Liabilities directly associated with non-current assets classified as held for sale | 21 | **1.0** | 7.9 |
| Provisions for liabilities and charges | 14 | **552.0** | 617.5 |
| Current tax liabilities | | **0.3** | 0.3 |
| Deferred tax liabilities | 15 | **72.5** | 84.0 |
| **Total liabilities** | | **32,260.1** | 35,568.4 |
| **Capital and reserves attributable to the Bank's equity holders** | | | |
| Ordinary share capital | 19 | **22.6** | 22.6 |
| Share premium account | 19 | **1,736.9** | 1,736.9 |
| Retained earnings | | **(513.3)** | (273.1) |
| Amounts recognised in OCI and accumulated equity relating to non-current assets held for sale | | **6.9** | – |
| Available for sale reserve | | **17.2** | 24.6 |
| Capital redemption reserve | | **410.0** | 410.0 |
| Cash flow hedging reserve | | **38.0** | 59.0 |
| | | **1,718.3** | 1980.0 |
| Non-controlling interests | | **34.7** | 34.5 |
| **Total equity** | | **1,753.0** | 2,014.5 |
| **Total liabilities and equity** | | **34,013.1** | 37,582.9 |

Approved by the Board on 19 August 2015:

**Dennis Holt,** Chairman
**Niall Booker,** Chief Executive

The notes on pages 67 to 111 form part of these financial statements.

# The Bank statement of cash flows

## For the period ended 30 June 2015 (unaudited)

All amounts are stated in £m unless otherwise indicated

| | Period to 30 June 2015 | Period to 30 June 2014 (restated) |
|---|---|---|
| **Cash flows used in operating activities** | | |
| Loss before taxation | **(204.2)** | (77.0) |
| Adjustments for: | | |
| (Increase)/decrease in prepayments and accrued income | **(4.5)** | 0.5 |
| Increase/(decrease) in accruals and deferred income | **17.5** | (36.7) |
| Interest payable in respect of other borrowed funds | **1.9** | 11.3 |
| Effect of exchange rate movements | **–** | (0.4) |
| Fair value movement on investment properties | **–** | 5.9 |
| Impairment gains on loans and advances | **(44.6)** | (86.7) |
| Movements on investment impairments | **–** | (1.1) |
| Depreciation and amortisation | **20.5** | 19.9 |
| Impairment of intangible assets | **–** | 0.4 |
| Interest amortisation | **(0.3)** | (3.3) |
| Fair value movements and amortisation of investment securities | **21.7** | (43.3) |
| Impairment of property, plant and equipment | **–** | 7.0 |
| (Profit)/loss on disposal of property, plant, equipment and software | **(0.2)** | 0.2 |
| Unwind of fair value adjustments arising on transfer of engagements | **12.0** | 47.1 |
| | **(180.2)** | (156.2) |
| Increase/decrease) in deposits by banks | **99.2** | (617.6) |
| Decrease in customer accounts and capital bonds | **(2,934.4)** | (1,566.6) |
| Decrease in debt securities in issue | **(538.3)** | (361.6) |
| Decrease in loans and advances to banks | **495.2** | 20.0 |
| Decrease in loans and advances to customers | **3,033.8** | 2,644.0 |
| Net movement of other assets and other liabilities | **72.2** | (90.0) |
| Income tax received | **–** | 5.3 |
| **Net cash flows from/(used in) operating activities** | **47.5** | (122.7) |
| **Cash flows (used in)/from investing activities** | | |
| Purchase of tangible and intangible fixed assets | **(23.2)** | (11.4) |
| Proceeds from sale of property, plant and equipment | **22.1** | 2.4 |
| Purchase of investment securities | **(943.4)** | (1,112.2) |
| Proceeds from sale and maturity of investment securities | **421.3** | 1,526.9 |
| **Net cash flows (used in)/from investing activities** | **(523.2)** | 405.7 |

## The Bank statement of cash flows continued

## For the period ended 30 June 2015 (unaudited)

All amounts are stated in £m unless otherwise indicated

| | Period to 30 June 2015 | Period to 30 June 2014 (restated) |
|---|---|---|
| **Cash flows (used in)/from financing activities** | | |
| Interest paid on other borrowed funds | **(1.9)** | (11.4) |
| Capital Commitment received from The Co-operative Group | **–** | 150.0 |
| Costs incurred relating to the May 2014 Capital Raising | **–** | (12.8) |
| Cash proceeds relating to the May 2014 Capital Raising | **–** | 400.0 |
| **Net cash flows (used in)/from financing activities** | **(1.9)** | 525.8 |
| | | |
| **(Decrease)/Increase in cash and cash equivalents** | **(477.6)** | 808.8 |
| **Cash and cash equivalents at the beginning of the period** | **5,577.1** | 6,092.2 |
| **Cash and cash equivalents at the end of the period** | **5,099.5** | 6,901.0 |
| | | |
| Cash and balances with central banks | **4,525.6** | 6,041.2 |
| Held for sale (note 21) | **12.8** | – |
| Loans and advances to banks | **561.1** | 704.8 |
| Short term investments | **–** | 155.0 |
| | **5,099.5** | 6,901.0 |

The cash flows differ from the Bank balance sheet movements as these movements include the non-cash unwinds of the fair value adjustments arising on the Britannia Building Society merger.

Following the change in the ownership of the Bank, amounts owed to and by The Co-operative Group undertakings are classified as third party balances.

Cash and balances with central banks as outlined in the cash flow above excludes the mandatory cash reserve balance of £52.1m.

The notes on pages 67 to 111 form part of these financial statements.

# The Bank statement of changes in equity

## For the period ended 30 June 2015 (unaudited)

All amounts are stated in £m unless otherwise indicated

| | Attributable to equity holders of the Bank | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Share capital | Share premium | Available for sale reserve | Cash flow hedging reserve | Capital redemption reserve | Retained earnings | HFS | Total | Non-controlling interest | Total equity |
| **Period from 1 January 2015 to 30 June 2015** | | | | | | | | | | |
| Balance at the beginning of the period (as restated) | **22.6** | **1,736.9** | **24.6** | **59.0** | **410.0** | **(273.1)** | | **1,980.0** | **34.5** | **2,014.5** |
| Total comprehensive (expense)/ income for the period | **–** | **–** | **(7.4)** | **(21.0)** | **–** | **(233.3)** | | **(261.7)** | **0.2** | **(261.5)** |
| Transactions with owners recorded directly in equity: | | | | | | | | | | |
| Transfer to held for sale | **–** | **–** | **–** | **–** | **–** | **(6.9)** | **6.9** | **–** | **–** | **–** |
| Dividend | **–** | **–** | **–** | **–** | **–** | **–** | **–** | **–** | **–** | **–** |
| **Balance at the end of the period** | **22.6** | **1,736.9** | **17.2** | **38.0** | **410.0** | **(513.3)** | **6.9** | **1,718.3** | **34.7** | **1,753.0** |
| Period from 1 July 2014 to 31 December 2014 (restated) | | | | | | | | | | |
| Balance at the beginning of the period (as restated) | 22.6 | 1,736.9 | (9.7) | 6.0 | 410.0 | (112.1) | – | 2,053.7 | 34.2 | 2,087.9 |
| Total comprehensive (expense)/ income for the period | – | – | 34.3 | 53.0 | – | (161.0) | – | (73.7) | 0.5 | (73.2) |
| Transactions with owners recorded directly in equity: | | | | | | | | | | |
| Dividend | – | – | – | – | – | – | – | – | (0.2) | (0.2) |
| Balance at the end of the period | 22.6 | 1,736.9 | 24.6 | 59.0 | 410.0 | (273.1) | – | 1,980.0 | 34.5 | 2,014.5 |
| Period from 1 January 2014 to 30 June 2014 (restated) | | | | | | | | | | |
| Balance at the beginning of the period (as restated) | 12.5 | 1,359.8 | (14.1) | 13.1 | 410.0 | (46.4) | – | 1,734.9 | 33.6 | 1,768.5 |
| Total comprehensive (expense)/ income for the period | – | – | 4.4 | (7.1) | – | (65.6) | – | (68.3) | 0.6 | (67.7) |
| Transactions with owners recorded directly in equity: | | | | | | | | | | |
| Issuance of new share capital | 10.1 | 389.9 | – | – | – | – | – | 400.0 | – | 400.0 |
| Transaction costs | – | (12.8) | – | – | – | – | – | (12.8) | – | (12.8) |
| Dividend | – | – | – | – | – | (0.1) | – | (0.1) | – | (0.1) |
| Balance at the end of the period (as restated) | 22.6 | 1,736.9 | (9.7) | 6.0 | 410.0 | (112.1) | – | 2,053.7 | 34.2 | 2,087.9 |

The notes on pages 67 to 111 form part of these financial statements.

# Notes to the Bank Interim Financial Report

## For the period ended 30 June 2015 (unaudited)

All amounts are stated in £m unless otherwise indicated

## 1. Basis of preparation and significant accounting policies

### 1.1 Basis of preparation

This condensed consolidated Interim Financial Report for the half year ended 30 June 2015 has been prepared in accordance with the Disclosure and Transparency Rules of the Financial Conduct Authority and with IAS 34 'Interim Financial Reporting', as adopted by the European Union. The Interim Financial Report should be read in conjunction with the Bank's 2014 financial statements, which have been prepared in accordance with IFRS as adopted by the European Union.

The information contained within this report for the half year 30 June 2015 does not constitute statutory accounts as defined by Section 434 of the Companies Act 2006. A copy of the statutory accounts for that year has been delivered to the Registrar of Companies. The auditor's report on those accounts was unqualified, did not contain a statement under section 498(2) or (3) of the Companies Act 2006, but did make reference to an emphasis of matter in relation to going concern (see note 1.3 for further detail).

The Interim Financial Report 2015 was approved by the Board of Directors on 19 August 2015.

### 1.2 Significant accounting policies

The same accounting policies and presentation are followed in the Interim Financial Report 2015 as applied in the 2014 Annual Report and Accounts. Significant additions and changes to underlying methodologies are discussed within the critical judgements and estimates section.

During July 2015 the IASB confirmed the deferral of the effective date of IFRS 15 Revenue from Contracts with Customers, by one year to 1 January 2018. Further information on pronouncements that will be relevant to the Bank in future periods is provided in the 2014 Annual Report and Accounts.

### 1.3 Going Concern

#### a. Introduction

These financial statements are prepared on a going concern basis. The Directors have a reasonable expectation that the Bank will have the resources to continue in business for the foreseeable future, taking into account the matters referred to below.

The assessment of the appropriateness of using the going concern basis of accounting has been subject to a thorough process involving analysis and discussion by management, Executive and Board Committees, in line with our governance processes. Discussions have also been held with the PRA regarding the Bank's ability to deliver against its previously communicated strategy. Whilst considering the Bank's Plan and forecasts, the Directors gave attention to the 12 month period following the date of approval of these financial statements.

The 2015–2019 plan has been reviewed and accepted by the PRA. This plan has not changed since submission in December 2014 and was designed to enable the Bank to withstand a severe stress by the end of the plan period and involves reshaping and restructuring the business around our individual and small business customers.

There does however continue to be material uncertainties around the Bank's ability to continue as a going concern which relate to the implementation of the plan as discussed in (e) below. In particular, the Bank needs ongoing regulatory acceptance of the Bank's position until the IT platform has been remediated and the Bank has rebuilt its capital strength to be able to withstand a significant stress.

#### b. The plan

The Co-operative Bank is a recognised brand and continues to maintain a loyal customer base. Our strategy is to reshape the business as a core relationship bank providing straightforward business banking and retail banking services to individuals and SMEs. Restructuring the business, including a reduction in head office costs, to drive a significant reduction of the cost base is an important part of the overall strategy.

A key element of the reshaping of the business is the reduction in Non-core assets, which currently carry the majority of the Risk Weighted Assets of the Bank. Reducing the Risk Weighted Assets will improve the Bank's CET1 and leverage ratios, and stressed capital resilience.

The revised plan, accepted by the PRA, accelerates the reduction in RWAs by expediting the deleveraging of the Optimum portfolio.

The Bank has started to deliver against its plan and improve its capital resilience. In the period to 30 June 2015 the Bank successfully completed two significant transactions; the securitisation of £1.5bn of Non-core residential mortgage assets within the Optimum portfolio, the largest deal of this type in the UK market since 2007, and the issuance of £250.0m of Tier 2 capital, as discussed on page 7.

#### c. Capital

Total CRD IV capital resources as at 30 June 2015 are £1.7bn (31 December 2014: £1.9bn) with Core Tier 1 capital after regulatory deductions of £1.5bn (31 December 2014: £1.6bn). The Bank's CET1 ratio stands at 14.9% (31 December 2014: 13.0%) on a CRD IV end point basis.

As at 30 June 2015, the Bank met the Individual Capital Guidance (ICG) for total capital set by the PRA, however it is not forecast to sustainably remain compliant against the currently in force ICG requirements for most of the duration of the 2015–2018 planning period.

# 1. Basis of preparation and significant accounting policies continued

## d. Liquidity

The Bank's liquid asset ratio was stable from 31 December 2014 to 30 June 2015 at 17.9%. The reduction in total assets was met with a proportionate reduction in primary liquidity holdings. The Bank complied with regulatory minima and the more prudent internal liquidity risk appetite throughout the period.

During the period to 30 June 2015, Customer Assets have continued to reduce primarily as a result of the Non-core asset disposals, reducing by a total of £2.5bn. The Bank has experienced a reduction of £3.2bn in Customer Liabilities following repricing activity on certain Savings products and intentionally low retention of maturing term deposits; the deposit reductions are necessary to offset deleverage activity and deliver the stable liquid asset ratio quoted above.

The Bank has redeemed the Silk Road Finance Number One securitisation in March 2015 of £1.1bn. The Warwick transaction completed in May 2015 and provided £0.8bn of net funding proceeds.

The Bank expects to stay above the current ILG regulatory minima across the planning period.

## e. Risks and uncertainties

Key risks associated with successful execution of the plan include:

1. The Bank is in the process of separating its operations from its former parent, The Co-operative Banking Group Limited, and its ultimate former parent, The Co-operative Group, with both of which it shares premises, systems and services. The work is complex and time consuming and despite forecasting that separation costs will be higher than originally envisaged, there remains a risk that the costs of executing these separation plans may increase further. The potential misalignment of Group and Bank's objectives may also make separation slower and more costly than anticipated;
2. The Bank participates in The Co-operative Group's defined benefit pension scheme (Pace). As long as the Bank remains a participating employer in Pace, the Bank could be 'last man standing' in the event of the failure of one or more of the other participating employers meaning that some or all of Pace's liabilities would need to be borne by the Bank. In addition, a material difference to current estimates of the funding of the pension scheme, or the Bank being forced to pay for a greater proportion than currently envisaged, could cause the Bank to increase the Bank's Pillar 2a Capital requirements or cause additional expense through increased contributions;
3. The Bank's IT systems have been underinvested in for a considerable period of time. The Bank needs to urgently and significantly improve and re-engineer its existing IT platform as the existing infrastructure is unsuitable and inherently fragile. There are also concerns about its resilience as the Bank's current IT disaster recovery plan has not been tested end to end. In January 2015 the Bank entered into an Enterprise Services (ES) contract with IBM in order to address this risk. However, until that work is completed, the Bank is at risk of an IT failure causing material disruption to the Bank's products and services. The required improvement and re-engineering of the Bank's IT platform and operational process is necessary and significant in scale, complexity and cost; in common with any programme of this scale it carries a significant level of execution risk. Any delays in, or failure by, the Bank to deliver the re-engineering of the Bank's IT platform may result in ongoing risk of technology failure, significant additional investment costs, subject the Bank to further regulatory scrutiny or sanction and impact the Bank's ability to deliver its strategy. The Bank's regulators are fully aware of the steps the Bank is taking to address these operational risks;
4. The Bank has entered into an outsourcing contract with Capita for the provision of mortgage processing. This creates execution risk as the processes and data migrate to Capita at the same time, as the Bank begins to manage data and information flows from the third party relationship. The Bank has not entered into such an arrangement in recent times and this generates significant risk in the short term should this not be delivered on an ongoing basis by the outsource provider and not be properly managed by the Bank. In the medium to longer term this arrangement helps reduce risk and provide resiliency;
5. The ability of the Bank to raise additional non-CET1 capital assumed in the plan beyond the Tier 2 issuance it has already successfully completed in first half 2015;
6. To move forwards with its plan, the Bank requires the regulators' ongoing acceptance of its inability to meet regulatory requirements and expectations. To the extent this is not forthcoming or to the extent that the Bank does not perform in line with its Business plan or regulatory capital requirements are increased for any reason, additional CET1 capital may be required over and above that included in that plan in order for the Bank to remain a going concern, and the PRA or FCA could exercise their powers under the Banking Act of 2009; and
7. More generally, the ability of the Bank to achieve the results set out in the 2015–2019 plan. In this respect particular challenges include (but are not limited to): ability to achieve the targeted cost savings; ability to retain customers and deposits; the timing and quantum of impacts to capital from the asset reduction exercise; meeting its planned improvements in net interest margin; the ability of the Bank to generate sufficient Core Bank asset growth; a possible further deterioration in the quality of the Bank's asset portfolio; unplanned costs from (for example) conduct risk matters, regulatory investigations, IT investment and the ability to maintain the Bank's access at, an appropriate cost, to liquidity and funding.

## f. Conclusion

The Directors have concluded that, despite lower than expected losses and higher CET1 for the period ended 30 June 2015, the risks set out above, and their consequential effects, represent a material uncertainty which may cast significant doubt upon the Bank's ability to continue as a going concern. The Bank may be unable to continue realising its assets and discharging its liabilities in the normal course of business. Nevertheless, after making enquiries of management and considering the current forecasts, in particular those for the 12 month period following the date of approval of these financial statements, the Directors have a reasonable expectation that the Bank will have adequate resources to continue in business over this period. For these reasons, they continue to adopt the going concern basis in preparing these financial statements. Therefore this set of financial statements does not include the adjustments that would result if the Bank was unable to continue as a going concern.

# 2. Critical judgements and estimates

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

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

The judgements and assumptions that are considered to be the most important to the portrayal of the Bank's financial condition are those relating to loan impairment provisions, conduct risk and legal provisions, deferred tax, pensions, hedge accounting, separation, effective interest rates (EIR) and fair value adjustments, and interest recognition relating to breaches of technical requirements of the Consumer Credit Act.

## a. Loan impairment provisions

### i. Overview

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

The calculation of impairment loss includes expectations of levels of future cash flow and is based on both the likelihood of a loan or advance being written off and the estimated loss on such a write off.

The changes in impairment provisions for all books of business result from management review of assumptions with respect to the determination and operational alignment of: the probability of the possession of collateral given default (PPD); treatment of forbearance; length of loss emergence periods; timing of impairment recognition, and the formalising of charge off policy.

Further explanation of the treatment of forborne balances is included in the Bank's risk management disclosures.

The section below explains the methodology for loan impairment for both the Core (unsecured and secured residential) and Non-core (Corporate and Optimum) segments. Only the critical elements of judgement are discussed in detail.

### ii. Collective provisions

Loans which have not been assessed individually for impairment are assessed for collective impairment. Collective provisions cover losses which have been incurred but not yet identified on loans subject to individual assessment and for homogeneous groups of loans that are not considered individually significant. Typically, retail lending portfolios are assessed for impairment on a collective basis as the portfolios generally consist of large pools of homogenous loans.

#### a) Core

##### i) Unsecured and secured residential

The Bank's collective provision for unsecured and secured retail personal advances is £109.2m (31 December 2014: £110.0m). Loans are identified as impaired by taking account of the stage of the debt's delinquency, the product type and the regularity of payments made whilst in arrears. The provision is calculated using assumed probabilities of default (PD) and a loss given default (LGD) for unidentified impairment.

The provision rates reflect the likelihood that the debt will be written off or charged off at some point in the future. The PD and LGD parameters are based on historical experience and are subject to regular review.

A key estimate within the unsecured models is the probability that impaired accounts move to a default status during the outcome period. The model uses historical actual data over a defined period of time to arrive at an average probability of accounts moving to default. If the maximum PD had been used for each category of arrears and for each product, this would increase the collective provision by £5.2m for all of the unsecured portfolios.

A key estimate of the secured impairment model provisioning is forced sales discount. The forced sales discount is an average and is calculated using historical actual data over a defined outcome period. If the maximum forced sales discount for the outcome period was used to calculate the provision across the secured portfolios excluding Optimum it would increase by £7.3m.

There were no significant changes made to the collective provision methodology in 2015.

#### b) Non-core

##### i) Corporate

The Bank's collective provision against corporate loans in the Non-core division has decreased to £15.8m (31 December 2014: £16.7m).

The collective provision is calculated using factors such as observed default rates and LGD. An assessment is made of the likelihood of the loan becoming recognised as impaired in the loss emergence period and for loans that are impaired the likelihood of them moving to default over the outcome period. The calculation of the collective provision relies heavily on assumed probabilities of default.

There were no significant changes to the collective provision methodology in 2015.

## 2. Critical judgements and estimates continued

The impact of increasing the default rates by 10% is an increase in the collective of £2.1m. The impact of decreasing by 10% the probability of resolution for defaulted customers is an increase in the collective of £1.8m. The impact of increasing other parameters that affect the loss rate by 10% is not significant.

#### ii) Optimum collective

In addition to the above, collective provisions of £9.5m (31 December 2014: £12.4m) are held in the Optimum segment of the Non-core business.

A key estimate is the collateral value. A 10% decrease to the indexed collateral used in the model would increase the provision by £17.7m.

There were no significant changes made to the collective provision methodology in 2015.

Further explanation of collection loan impairment methodology is included in the Bank's risk management disclosures.

### iii. Individual provisions

Individual provisions are recorded for loans which are assessed for impairment on an individual basis. Loans considered as individually significant are typically Corporate loans.

#### a) Core

#### i) Unsecured and secured residential

Individual provisions for unsecured and secured residential lending total £5.3m (31 December 2014: £4.5m). There were no significant changes made to the provision methodology in 2015. Sensitivities to the key estimates within the secured residential individual impairment model are disclosed in the risk management section.

#### b) Non-core

#### i) Corporate

The Bank's individual impairment provision on Corporate loans totals £327.1m (31 December 2014: £386.8m). The provision has decreased reflecting improving macroeconomic factors and the Bank's strategic deleveraging of Non-core assets.

The determination of individual impairment provisions requires the exercise of considerable management judgement involving matters such as economic conditions and the resulting trading performance of the customer and the value of security held, for which there may not be a readily accessible market. In particular, significant judgement is required by management in assessing the borrower's cash flows and debt servicing capability together with the realisable value of collateral. The actual amount of the future cash flows and their timing may differ from the assumptions made for the purposes of determining the impairment provision and consequently these provisions can be subject to change over time. A key estimate within the provision is collateral valuation. A 10% decrease in collateral values would increase the provision by £25.6m.

For further information on credit risk and impairment, see the Bank's risk management disclosures.

#### ii) Optimum individual

The Bank's individual impairment provision on Optimum mortgages is £nil (31 December 2014: £9.5m). Mortgage accounts are identified as impaired and provided for on an individual basis by taking account of the stage of the debt's delinquency.

There were no significant changes made to the provision methodology in 2015. The decrease in the provision reflects the deleverage of a portion of the portfolio in 2015, improving quality of the loan book and improved House Price Index (HPI) values.

## b. Conduct risk and legal provisions

### i. Overview

The Bank has identified a number of conduct risk and legal issues against which it has raised provisions, based on management's best estimate of the total potential costs to the Bank.

The calculation of these conduct and legal provisions requires significant judgement by management in determining appropriate assumptions. Key assumptions include basis of redress, operating costs of resolving redress, legal analysis, the level of complaints, Bank uphold rates, proactive contact and response rates, and the Financial Ombudsman Service referral and uphold rates. This is discussed in more detail in the 2014 Annual Report and Accounts.

All amounts are stated in £m unless otherwise indicated

## 2. Critical judgements and estimates continued

### ii. Payment Protection Insurance (PPI)

A provision of £44.6m (31 December 2014: £73.6m) has been recorded in respect of potential customer redress relating to past sales of PPI. The provision is in respect of the total expected cost of carrying out this work and paying compensation, making total provisions raised to date of £352m (31 December 2014: £352m).

There are a number of key assumptions within the calculation of the current provision. The key assumptions within the calculation of the current provision are complaint volumes, uphold rates, administration costs, proactive response rate and retrospective redress.

The current position, expected movement in position and baseline sensitivities of the key estimates are outlined below:

| Description of estimate | Current position | Future expected | Sensitivity on current position |
|---|---|---|---|
| Number of inbound valid[1] complaints | 88,000 | 15,000 | 1,000 = £1.3m |
| Number of proactive mailings | 43,000 | 4,000 | 1,000 = £1.6m |
| Response rate to proactive mailings | 60% | 60% | 1% = £1.5m |
| Average uphold rate per valid[1] complaint | 64% | 58% | 1% = £0.3m |
| Average redress per upheld complaint | £3,230 | £1,746 | £100 = £1.0m |

1. Valid complaints excludes those complaints for which no PPI policy exists.

These assumptions remain subjective, in particular due to the uncertainty associated with future claims levels. The resulting provision represents the best estimate of all future expected costs of PPI redress. However, it is possible the eventual outcome may differ from the current estimate and if this were to be material an adjustment to the provision will be made. The provision also includes an estimate of the Bank's claims handling costs and those costs associated with claims that are subsequently referred to the Financial Ombudsman Service.

A 2014 decision of the UK Supreme Court (Plevin) held that, judged on its own facts, non-disclosure of the amount of commissions payable in connection with the sale of single premium PPI to a customer could create an unfair relationship under provisions of the UK Consumer Credit Act. In line with other banking industry participants, The Co-operative Bank plc is participating in an active financial services industry wide dialogue with the FCA and the FOS to determine any possible wider impact of such decision on its historical sales of single and repeat premium PPI. The decision has a potential impact on a number of the Bank's customers who may have a claim for PPI mis-selling and treatment of prior claims. Due to this uncertainty it is not currently practicable to provide an estimate of any financial impact the Plevin decision could have and there can be no assurance that the outcome of this matter will not be material.

### iii. Interest rate hedging past business review

The Bank previously voluntarily agreed to participate in the FCA's Interest Rate Hedging (IRH) Past Business Review (PBR).

A provision of £8.6m (31 December 2014: £14.8m) for potential interest rate swap mis-selling has been recorded. The decrease in the provision reflects the utilisation of the opening provision in the period.

Calculations on redress have been performed based upon the latest guidance from both the FCA and a Skilled Person (as defined by the FCA). The final redress method has not, however, been confirmed in all cases.

There are a number of key assumptions within the calculation of the current provision. The key assumptions within the calculation of the current provision are the population of in scope swaps and the methodology to calculate redress provision.

### iv. Breaches of the technical requirements of the Consumer Credit Act (legal provision)

An amount of £167.5m (31 December 2014: £169.4m) has been provided regarding interest refunds following identification of breaches of the technical requirements of the CCA. The decrease in the provision reflects the utilisation of the opening provision in the period. This has offset an increase in the provision for further interest chargeable on affected loans in accordance with relevant loan agreements which requires redressing and an updated estimate of the costs which will be incurred in delivering redress. The provision will continue to increase in line with interest charged until the issue is fully remediated.

Assumptions for provisioning purposes are that the payment profile of loans was as per those agreed at drawdown. The provision covers all interest accrued during non-compliance to the end of June 2015.

Within the provision, operating costs of £13.1m (31 December 2014: £17.6m) are based upon the latest view of delivery timeframes.

# 2. Critical judgements and estimates continued

### v. Packaged accounts

An amount of £33.1m (31 December 2014: £17.4m) has been provided in respect of potential customer redress relating to past sales of packaged accounts. There are a number of key assumptions within the calculation of the current provision. The key assumptions within the calculation of the current provision are complaint volumes, uphold rates, administration costs, proactive response rate and retrospective redress. The provision has increased in 2015 following the identification of additional populations of customers to be redressed within the programme and inbound complaints.

These assumptions remain subjective, in particular due to the uncertainty associated with future claims levels. The resulting provision represents the best estimate of all future expected costs of packaged accounts redress. However, it is possible the eventual outcome may differ from the current estimate and if this were to be material an adjustment to the provision will be made. The provision also includes an estimate of the Bank's claims handling costs and those costs associated with claims that are subsequently referred to the Financial Ombudsman Service.

The key sensitivity in the calculation of the provision is the uphold rate on complaints received. If the uphold rate increased by 5%, then the provision would increase by £2.5m.

Within the provision, operating costs of £7.3m (31 December 2014: £4.4m) are based upon the latest view of delivery timeframes.

### vi. Other conduct/compliance related provisions

Other conduct/compliance related provisions include the following:

- £12.6m (31 December 2014: £17.8m) for potential customer redress relating to the processing of first payments on certain mortgages;
- £24.0m (31 December 2014: £24.0m) relating to potential customer redress in relation to mortgage early redemption charges;
- £14.1m (31 December 2014: £14.9m) for alleged failings in the introduction of third party sales of card and identification protection products (as part of an industry wide review announced by the FCA on 27 January 2015);
- £10.2m (31 December 2014: £20.0m) relating to potential customer redress due to mortgage customer detriment;
- £33.6m (31 December 2014: £34.8m) for potential customer redress in relation to arrears fees and charges;
- £11.4m (31 December 2014: £15.0m) relating to provision for potential conduct issues incurred but not identified;
- £5.7m (31 December 2014: £7.0m) relating to potential customer redress and other costs in relation to mortgage documentation;
- £16.6m (31 December 2014: £15.2m) relating to cost of mortgage redress; and
- £12.6m (31 December 2014: £12.2m) of other conduct provisions.

Key assumptions include basis of redress, legal analysis, operating costs of resolving redress, level of complaints, uphold rates, proactive contact and response rates and Financial Ombudsman Service referral and uphold rates. The above provisions have a significant range of highly judgemental outcomes, the most significant of which reside within the provision for mortgage customer detriment. Given the Bank is still in the process of identifying the population of affected customers it carries the inherent risk of forecasting for subjective final outcomes. A reasonably possible change of increasing by 10% the number of customers with closed accounts who have experienced detriment, could increase the provision for customer redress by £3.5m.

## c. Deferred tax

The Bank has recognised a deferred tax asset of £16.9m (31 December 2014: £21.0m) which includes £0.5m (31 December 2014: £0.9m) within a disposal group classified as held for sale. The Bank has recognised a deferred tax liability of £72.5m (31 December 2014: £84.0m). Deferred tax has been calculated using a tax rate of 20%.

The deferred tax asset relates to temporary differences arising on consolidation adjustments where the recoverability is not dependent on the future performance of the Bank and temporary differences in subsidiaries that are forecast to make taxable profits. The Bank has not recognised a deferred tax asset in respect of any other trading losses, capital losses or temporary differences as doubt exists over the availability of sufficient future taxable profits.

## d. Pensions

### i. Defined contribution accounting for the Pace scheme

The Bank participates in Pace. Pace is a hybrid scheme, consisting of a defined benefit section and a defined contribution section. There is currently insufficient information available to consistently and reliably identify the Bank's share of its liabilities in respect of this multi-employer scheme. For this reason defined benefit accounting is not possible and pension costs in respect of Pace are accounted for on a defined contribution basis in accordance with IAS 19 Employee Benefits (revised 2011). Pension costs are recognised as an expense in the Bank's income statement.

A provision of £5.4m (31 December 2014: £2.9m) has been recognised in relation to the annual deficit funding which the Bank has agreed to pay. This covers the period to July 2016. A further agreement on deficit funding may be reached at that point if the overall liability position has not been resolved at that time. See note 16 for further details.

## 2. Critical judgements and estimates continued

### ii. Defined benefit accounting for the Britannia scheme

The Britannia scheme is a hybrid scheme, consisting of a defined benefit section and a defined contribution section. In 2009, following the transfer of engagements of Britannia Building Society, CFSMS, a Co-operative Banking Group subsidiary, became principal employer of the scheme. The Bank and three wholly owned subsidiaries (Platform Funding Limited, WMS and Britannia International) are participating employers in this multi-employer scheme. This scheme is now closed.

Following further operational separation of the Bank from the wider Co-operative Group, the Britannia scheme was recognised on the Bank's balance sheet during 2014 and is now accounted for on a defined benefit basis.

The next full (triennial) actuarial funding valuation of the Britannia Pension Scheme, with an effective date of 5 April 2014, is currently ongoing, and is expected to be completed in October 2015.

Further information on the financial implications of accounting for the Britannia scheme on a defined benefit basis is disclosed in note 16.

### e. Hedge accounting

The Bank reviewed its hedge accounting methodology in the prior year and concluded that the method for calculating hedge ineffectiveness should be revised to better align with industry practices under IAS 39 (Financial Instruments: Recognition and Measurement). This has resulted in the recognition of an accounting loss in the year and a restatement of prior years.

These changes will result in additional accounting volatility in future financial periods, although this merely represents changes in the timing of recognition of profit or loss and not in the overall economic value of the hedge itself.

### f. Interest recognition (CCA)

During 2013, breaches of the technical provisions of the CCA were identified resulting in the Bank not being legally entitled to the interest on the loans subject to a breach. The Bank anticipates redressing customers and rectifying loan documentation throughout 2015, at which point the Bank becomes compliant with the CCA and the Bank can start recognising interest on the loans again.

The interest recognised on unsecured lending subject to a CCA breach was previously recognised within the interest income line, with an equal deduction for the amount recognised directly below interest income presented on the income statement. The presentation has been amended for the period and this income has not been recognised.

### g. Separation provision

During November 2013, the Bank publicly announced its intention to separate from The Co-operative Group. The Bank carries a provision of £75.7m (31 December 2014: £112.3m) in relation to separation costs which are eligible to be provided for under IAS 37 (Provisions, Contingent Liabilities and Contingent Assets).

The separation provision represents the costs directly relating to the Bank's obligation to separate from The Co-operative Group. The calculation of the separation provision requires significant judgement by management in determining appropriate assumptions. Key assumptions include the day rate which will be paid to contract staff as part of the separation of Enterprise Services Programme and the overall time it will take to achieve separation.

### h. Effective Interest Rate and Fair Value adjustments

When calculating the EIR to apply to an asset or liability held at amortised cost, the Bank estimates future cash flows considering all contractual terms of an instrument. In most cases, the future cash flows arising from an asset or liability will be dependent on a number of variables, such as the proportion of mortgage customers who do not switch product after a discount period ends, or future interest rates set by the market. Therefore, it follows that management is required to apply significant judgement in creating assumptions about the value of these variables in the future.

In calculating the EIR adjustment to apply to mortgage balances, the most significant assumption in terms of impact and volatility is the assumed standard variable rate which will be in effect at the end of a fixed rate product term. This is determined with reference to expected Bank of England base rate rises, with a proportion of future increases assumed to pass through to the Bank's standard variable rate. As a measure of the sensitivity of this input, a 0.5% increase in the assumed standard variable rate in place at the end of all fixed rate products would result in a £6.5m (35%) increase in the EIR adjustment required to the loans and advances to customers balance as at 30 June 2015.

On the merger of the Bank and Britannia Building Society in August 2009, an exercise was undertaken to fair value the respective assets and liabilities of Britannia Building Society. These fair value adjustments are unwound on an EIR basis over the effective lives of the assets and liabilities. Management is required to apply significant judgement in determining the EIR assumptions which underpin the unwind profile of the fair value adjustments. The most significant assumption in terms of impact and volatility in determining the unwind profile for fair value adjustments is the remaining average lives of the related instruments.

The most significant fair value adjustment is that made to the Leek debt securities, which were valued below par upon merger. This adjustment has been unwinding towards the call date of the underlying Leek debt securities. As a measure of the sensitivity of the remaining lives on these instruments, if the Leek notes were to be redeemed one month earlier than the call date, the Leek notes fair value adjustment would decrease by £2.7m (0.9%) as at 30 June 2015, resulting in additional expense of £2.7m in the period to 30 June 2015.

## 2. Critical judgements and estimates continued

### i. Derecognition of financial assets

The Bank closed its inaugural whole structure securitisation as part of its Non-core optimum residential mortgage portfolio through the issuance of notes and residual certificates by Warwick Finance 1. Those assets were assessed for derecognition on a stand alone and consolidated basis in accordance with IAS 39.

#### Stand alone basis

Pass through test

Under the pass through test, the obligation to pay the cashflows from the mortgages to Warwick Finance 1 was met since payments from the mortgage borrower are made into the collection accounts required to be transferred to Warwick Finance 1 on the next business day.

Risk and rewards test

The Bank has assessed whether substantially all the risks and rewards of ownership of the mortgages to Warwick Finance 1 have been transferred. Whilst the Bank retains an interest in Class A notes, the holders of residual certificates are independent to third parties, fees and terms and conditions are on an arms length basis, and the Bank is not consulted over decision to make further advances with regard to mortgages which have been securitized as part of this transaction. The Bank has therefore concluded that the risks and rewards test is met.

#### Requirement to consolidate the results of Warwick Finance 1

Variable rights of return

The Bank has assessed whether it has exposure or rights to variable returns from involvement with Warwick Finance 1, and if it has the ability to affect those returns. At 30 June the Bank owned WMSL, which provided services to Warwick Finance 1, however the Bank only acts as agent for junior and residual note holders and not as a principal acting in its own interest. Hence the Bank has no power over Warwick Finance 1 and is only exposed to a de-minimus variable return from Warwick Finance 1. Since the Bank sold WMSL on 1 August 2015 the Bank now has no further de-minimus powers over this entity. The Bank therefore concluded that Warwick Finance 1 should not be consolidated into its results.

## 3. Restatements

The following restatements are in line with those disclosed in the 2014 Annual Report and Accounts, and have been reassessed to determine the impact on the prior period Income Statement.

### Hedge accounting

In accordance with its Accounting Volatility Management Strategy, the Bank elects to make use of different hedge accounting techniques in order to eliminate (as far as possible) any profit or loss generated purely through the implementation of accounting standards (as opposed to actual economic losses).

The Bank applies two types of hedge accounting - cash flow hedge accounting and fair value hedge accounting. These hedging methodologies are used on both a micro basis (one underlying asset or liability hedged by one derivative) and a macro basis (a portfolio of assets or liabilities hedged by a combination of derivatives).

In prior periods the Bank incorrectly included the interest rate element of a small number of swaption contracts as part of the cash flow hedging model. This was amended in the second half of 2014 resulting in a restatement of prior periods.

The effect of the change was to reduce retained earnings in the period to 30 June 2014 by £2.5m.

### Corporate interest fair value

An interest fair value asset was recorded at the time of the merger of the Bank with the Britannia Building Society in 2009. This asset has been unwound in line with the expected behavioural lives of the assets. The Bank has reviewed the methodology and modelling of the unwind of this asset and has concluded that an acceleration in the unwind would be required to the half year ended 30 June 2014. This resulted in a £1.3m credit to retained earnings in the period to 30 June 2014.

### Deferred Tax Asset recognition (DTA) in subsidiaries

The Bank has reviewed its methodology for deferred tax recognition across all of the companies and has concluded that additional deferred tax assets and liabilities should be recognised as at 31 December 2013 in respect of two of the Bank's subsidiaries, Platform Funding Limited (PFL) and Mortgage Agency Services Number Five Limited (MAS5). This restatement together with the restatement of other deferred tax positions previously unrecognised as at 31 December 2013 has resulted in a deferred tax debit of £6.8m to the income statement for the period to 30 June 2014 and a deferred tax credit to other comprehensive income for the period of £2.2m. No deferred tax was subsequently recognised in MAS5 at 31 December 2014 due to the likelihood of an Optimum deleverage. All of the business of MAS5 relates to Optimum.

All amounts are stated in £m unless otherwise indicated

## 3. Restatements continued

### Provisions for conduct redress

Provisions for conduct redress in the period to 30 June 2014 of £4.0m, £5.0m and £8.6m included within interest income, fee and commission expense and operating expenses respectively, have been aggregated and disclosed separately on the face of the income statement.

The effect of the prior period restatements on the Bank are:

### Income Statement

| | Note | 30 June 2014 (as reported) | Restated | Represented | 30 June 2014 (restated) |
|---|---|---|---|---|---|
| Interest income | 5 | 541.3 | 1.3 | (4.0) | 538.6 |
| Fee and commission income | 6 | 99.9 | – | 5.0 | 104.9 |
| Other operating expenses | 7 | (1.6) | (2.5) | – | (4.1) |
| Operating expenses | 8 | (401.9) | – | 8.6 | (393.3) |
| Provision for customer redress | | – | – | (9.6) | (9.6) |
| Loss for the period before taxation | 10 | (75.8) | (1.2) | – | (77.0) |
| Income tax | 10 | 19.1 | (6.8) | – | 12.3 |

The impact on regulatory capital is described in the Capital Management section on page 53.

## 4. Segmental information

The Bank is managed as two divisions - Core and Non-core. Core represents activity consistent with the strategy and risk appetite of the Bank. This includes Retail, Business and Commercial Banking (BaCB), Treasury and Other segments. Non-core business lines include activities not aligned with the current strategy of the Bank which are targeted for run down or exit.

Revenues are attributed to the segment in which they are generated. Transactions between the reportable segments are on normal commercial terms and internal charges and transfer pricing adjustments have been reflected in each segment.

Further detail of the components of the Core and Non-core segments is provided on pages 14 and 16.

| | Core | | | | | Non-core | | | |
|---|---|---|---|---|---|---|---|---|---|
| | **Retail** | **BaCB** | **Treasury** | **Other[1]** | **Total Core** | **Corporate CoAM** | **Optimum** | **Total Non-core** | **Total** |
| **Period to 30 June 2015** | | | | | | | | | |
| Net interest income/(expense) | **204.9** | **20.3** | **(0.3)** | **6.4** | **231.3** | **(6.3)** | **8.6** | **2.3** | **233.6** |
| Losses on asset sales | **–** | **–** | **(0.1)** | **–** | **(0.1)** | **(35.3)** | **(2.8)** | **(38.1)** | **(38.2)** |
| Non-interest income/(expense) | **28.1** | **5.6** | **0.6** | **(3.7)** | **30.6** | **8.2** | **2.3** | **10.5** | **41.1** |
| **Operating income** | **233.0** | **25.9** | **0.2** | **2.7** | **261.8** | **(33.4)** | **8.1** | **(25.3)** | **236.5** |
| Direct costs | **(76.4)** | **(5.2)** | **(4.1)** | **(4.8)** | **(90.5)** | **(5.6)** | **(0.5)** | **(6.1)** | **(96.6)** |
| Impairment gains/(losses) on loans and advances | **(4.6)** | **1.0** | **–** | **0.9** | **(2.7)** | **44.8** | **2.5** | **47.3** | **44.6** |
| **Contribution result** | **152.0** | **21.7** | **(3.9)** | **(1.2)** | **168.6** | **5.8** | **10.1** | **15.9** | **184.5** |
| Operations and central costs | | | | | | | | | **(163.0)** |
| Project costs | | | | | | | | | **(101.9)** |
| **Operating result** | | | | | | | | | **(80.4)** |
| PPI, conduct and legal risk provisions | | | | | | | | | **(49.0)** |
| Share of post-tax profits from joint ventures | | | | | | | | | **–** |
| Financial Services Compensation Scheme Levies | | | | | | | | | **(20.5)** |
| Fair value amortisation | | | | | | | | | **(54.3)** |
| **Loss before taxation** | | | | | | | | | **(204.2)** |
| Income tax | | | | | | | | | **(28.9)** |
| **Loss for the period** | | | | | | | | | **(233.1)** |

All amounts are stated in £m unless otherwise indicated

## 4. Segmental information continued

1. Unity Trust Bank operates in the social economy and commercial banking sectors and is consolidated into the Bank's results on the basis of control. On 14 January 2014, it was announced that the Bank is in discussions with the Board of Unity Trust Bank about a potential sale of its 26.7% shareholding. Discussions continue but remain at an early stage and any decision on a changed ownership structure would be subject to regulatory approval.

Unity Trust Bank is registered in England and Wales and operates in the UK.

| | Core | | | | | Non-core | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| Restated | Retail | BaCB | Treasury | Other[1] | Total Core | Corporate CoAM | Optimum | Illius | Total Non-core | Total |
| **Period to 30 June 2014** | | | | | | | | | | |
| Net interest income/(expense) | 201.5 | 23.0 | (9.3) | 5.7 | 220.9 | 13.1 | 17.3 | (2.1) | 28.3 | 249.2 |
| Gains/(losses) on asset sales | – | – | (2.1) | – | (2.1) | 4.0 | – | – | 4.0 | 1.9 |
| Non-interest income/(expense) | 55.9 | 7.9 | (21.6) | 3.1 | 45.3 | 10.5 | 2.4 | (2.0) | 10.9 | 56.2 |
| **Operating income** | 257.4 | 30.9 | (33.0) | 8.8 | 264.1 | 27.6 | 19.7 | (4.1) | 43.2 | 307.3 |
| | | | | | | | | | | |
| Direct costs | (78.4) | (8.7) | (7.2) | (4.2) | (98.5) | (9.3) | (2.6) | (2.3) | (14.2) | (112.7) |
| Impairment gains/(losses) on loans and advances | (1.3) | (1.4) | – | 1.2 | (1.5) | 79.3 | 9.0 | (0.1) | 88.2 | 86.7 |
| **Contribution result** | 177.7 | 20.8 | (40.2) | 5.8 | 164.1 | 97.6 | 26.1 | (6.5) | 117.2 | 281.3 |
| Operations and central costs | | | | | | | | | | (184.3) |
| Project costs | | | | | | | | | | (68.8) |
| **Operating result** | | | | | | | | | | 28.2 |
| | | | | | | | | | | |
| PPI, conduct and legal risk provisions | | | | | | | | | | (38.6) |
| Share of post-tax profits from joint ventures | | | | | | | | | | (0.1) |
| Financial Services Compensation Scheme Levies | | | | | | | | | | (25.3) |
| Fair value amortisation | | | | | | | | | | (41.2) |
| **Loss before taxation** | | | | | | | | | | (77.0) |
| Income tax | | | | | | | | | | 12.3 |
| **Loss for the period** | | | | | | | | | | (64.7) |

All amounts are stated in £m unless otherwise indicated

## 4. Segmental information continued

| | Period to 30 June 2015 | Restated Period to 30 June 2014 |
|---|---|---|
| **Net interest income** | | |
| Total interest margin for reportable segments | **233.6** | 249.2 |
| Gains/losses on asset sales | **–** | – |
| Interest fair value unwind | **(51.6)** | (45.0) |
| Provision for customer redress claims | **(20.0)** | (29.0) |
| Other | **(0.1)** | – |
| Net interest income | **161.9** | 175.2 |
| **Non-interest income** | | |
| Total non-interest income for reportable segments | **41.1** | 56.2 |
| Losses/Gains on asset sales | **(38.2)** | 1.9 |
| Interest fair value unwind | **–** | 6.0 |
| Provision for customer redress claims | **–** | – |
| Non-interest income | **2.9** | 64.1 |
| Comprising: | | |
| Net fee and commission income | **47.7** | 68.0 |
| Income from investments | **0.1** | – |
| Net trading income | **–** | 0.2 |
| Other operating expense | **(44.9)** | (4.1) |
| | **2.9** | 64.1 |
| **Operating expenses** | | |
| Total direct costs for reportable segments | **(96.6)** | (112.7) |
| Interest fair value unwind | **(2.7)** | (2.2) |
| Operations and central costs | **(163.0)** | (184.3) |
| Project costs | **(101.9)** | (68.8) |
| Provision for customer redress claims | **(29.0)** | (9.6) |
| Re-presentation of fraud costs | **–** | – |
| Impairment reclassification | **–** | – |
| Financial Services Compensation Scheme Levies | **(20.5)** | (25.3) |
| Provision for conduct risk | **–** | – |
| Other | **0.1** | – |
| Operating expenses | **(413.6)** | (402.9) |
| **Interest fair value unwind** | | |
| Total interest unwind for reportable segments | **(54.3)** | (41.2) |
| Interest margin unwind | **51.6** | 45.0 |
| Non-interest income unwind | **–** | (6.0) |
| Operating expenses unwind | **2.7** | 2.2 |
| Interest fair value unwind | **–** | – |
| **Impairment gains on loans and advances** | | |
| Total impairment gains on loans and advances for reportable segments | **44.6** | 86.7 |
| | **–** | – |
| Other | **–** | – |
| Impairment gains on loans and advances | **44.6** | 86.7 |

The above table reconciles information used for management purposes, as disclosed in the detailed financial review with the statutory disclosures, in the Bank income statement on page 61.

All amounts are stated in £m unless otherwise indicated

## 4. Segmental information continued

They have also been re-presented in respect of costs to reflect the way these are now managed and reported within the Bank.

The 2014 comparatives have been restated as described in note 3.

| | Core | | | | | Non-core | | | |
|---|---|---|---|---|---|---|---|---|---|
| | Retail | BaCB | Treasury | Other | Total Core | Corporate CoAM | Optimum | Total Non-core | Total |
| **As at 30 June 2015** | | | | | | | | | |
| Segment assets | **14,187.5** | **554.0** | **9,761.3** | **862.7** | **25,365.5** | **3,006.9** | **5,021.0** | **8,027.9** | **33,393.4** |
| Unallocated assets | | | | | | | | | **710.5** |
| Total assets for reportable segments | | | | | | | | | **34,103.9** |
| Statutory adjustments | | | | | | | | | **(90.8)** |
| **Bank total assets** | | | | | | | | | **34,013.1** |

| | Core | | | | | Non-core | | | |
|---|---|---|---|---|---|---|---|---|---|
| | Retail | BaCB | Treasury | Other | Total Core | Corporate CoAM | Optimum | Total Non-core | Total |
| **As at 30 June 2015** | | | | | | | | | |
| Segment liabilities | **22,729.5** | **2,775.0** | **4,024.1** | **815.4** | **30,344.0** | **356.9** | **–** | **356.9** | **30,700.9** |
| Unallocated liabilities | | | | | | | | | **1,219.6** |
| Total liabilities for reportable segments | | | | | | | | | **31,920.5** |
| Statutory adjustments | | | | | | | | | **339.6** |
| **Bank total liabilities** | | | | | | | | | **32,260.1** |

| | Core | | | | | Non-core | | | |
|---|---|---|---|---|---|---|---|---|---|
| | Retail | BaCB | Treasury | Other | Total Core | Corporate CoAM | Optimum | Total Non-core | Total |
| **As at 31 December 2014** | | | | | | | | | |
| Segment assets | 14,611.4 | 620.0 | 9,729.4 | 515.4 | 25,476.2 | 3,930.1 | 6,822.9 | 10,753.0 | 36,229.2 |
| Unallocated assets | | | | | | | | | 1,069.8 |
| Total assets for reportable segments | | | | | | | | | 37,299.0 |
| Statutory adjustments | | | | | | | | | 283.9 |
| **Bank total assets** | | | | | | | | | 37,582.9 |

| | Core | | | | | Non-core | | | |
|---|---|---|---|---|---|---|---|---|---|
| | Retail | BaCB | Treasury | Other | Total Core | Corporate CoAM | Optimum | Total Non-core | Total |
| **As at 31 December 2014** | | | | | | | | | |
| Segment liabilities | 25,562.3 | 2,837.0 | 4,523.3 | 468.4 | 33,391.0 | 557.4 | – | 557.4 | 33,948.4 |
| Unallocated liabilities | | | | | | | | | 1,109.8 |
| Total liabilities for reportable segments | | | | | | | | | 35,058.2 |
| Statutory adjustments | | | | | | | | | 510.2 |
| **Bank total liabilities** | | | | | | | | | 35,568.4 |

Unallocated assets are non-customer assets and liabilities that are not allocated to a particular segment. Statutory adjustments mainly relate to the reallocation of provisions, accruals and prepayments and the gross up of mark to market values.

All amounts are stated in £m unless otherwise indicated

## 5. Net Interest income

| | Period to 30 June 2015 | Restated Period to 30 June 2014 |
|---|---|---|
| **Interest receivable and similar income** | | |
| On financial assets not at fair value through profit or loss: | | |
| On loans and advances to customers | **402.1** | 540.2 |
| On loans and advances to banks | **10.1** | 17.2 |
| On investment securities | **31.6** | 29.6 |
| | **443.8** | 587.0 |
| On financial assets at fair value through profit or loss: | | |
| Net interest expense on financial instruments hedging assets | **(36.3)** | (54.9) |
| Net interest income on financial instruments not in a hedging relationship | **8.2** | 6.5 |
| | **415.7** | 538.6 |

The 2014 comparatives have been restated as described in note 3.

| | Period to 30 June 2015 | Restated Period to 30 June 2014 |
|---|---|---|
| **Interest expense and similar charges** | | |
| On financial liabilities not at fair value through profit or loss: | | |
| On customer accounts | **(130.1)** | (214.6) |
| On bank and other deposits | **(127.6)** | (118.8) |
| On subordinated liabilities | **(1.9)** | (11.3) |
| | **(259.6)** | (344.7) |
| On financial liabilities at fair value through profit or loss: | | |
| Net interest income/(expense) on financial instruments hedging liabilities | **10.2** | (8.4) |
| Net interest expense on financial instruments not in a hedging relationship | **(4.4)** | (10.3) |
| | **(253.8)** | (363.4) |
| **Net interest income** | **161.9** | 175.2 |

Interest expense on bank and other deposits includes interest expense on deposits by banks and on debt securities in issue. It also includes fair value unwind on debt securities in issue of £66.4m (30 June 2014: £53.8m), further details of which are provided in note 20.

All amounts are stated in £m unless otherwise indicated

## 6. Net fee and commission income/(expense)

| | Period to 30 June 2015 | Restated Period to 30 June 2014 |
|---|---|---|
| **Fee and commission income** | | |
| On items not at fair value through profit or loss | **64.2** | 104.8 |
| On trust or fiduciary activities that result from holding or investing in assets on behalf of others | **0.1** | 0.1 |
| | **64.3** | 104.9 |

The 2014 comparatives have been restated as described in note 3.

| | Period to 30 June 2015 | Restated Period to 30 June 2014 |
|---|---|---|
| **Fee and commission expense** | | |
| On items not at fair value through profit or loss | **(16.3)** | (36.8) |
| On items at fair value through profit or loss | **(0.3)** | (0.1) |
| | **(16.6)** | (36.9) |
| **Net fee and commission income** | **47.7** | 68.0 |

## 7. Other operating income/(expense)

| | Period to 30 June 2015 | Restated Period to 30 June 2014 |
|---|---|---|
| Rent receivable from investment properties | **–** | 4.2 |
| Income from derivatives and hedge accounting | **29.2** | – |
| Other | **(40.0)** | (8.3) |
| Loss on sale of assets – loans and receivables | **(34.0)** | – |
| **Total other operating expense** | **(44.8)** | (4.1) |

On 6 May 2015, the Bank closed its inaugural whole structure securitisation of part of its Non-core Optimum residential mortgages portfolio through the issuance of notes and residual certificates by Warwick Finance Residential Mortgages Number One PLC (Warwick Finance One).

Within the loss on sale of assets, £2.6m relates to the sale of mortgage assets and £31.4m for the sale of corporate loans.

This is discussed in more detail in the Business and Detailed Financial Review.

All amounts are stated in £m unless otherwise indicated

## 8. Operating expenses

| | Note | Period to 30 June 2015 | Period to 30 June 2014 |
|---|---|---|---|
| **Operating Expenses** | | | |
| Staff costs | 9 | **166.5** | 146.5 |
| Administrative expenses | | **117.9** | 143.9 |
| Depreciation of property, plant and equipment | | **6.1** | 7.0 |
| Amortisation of intangible fixed assets | | **14.3** | 12.9 |
| Amortisation and depreciation of non-current assets classified as held for sale | | **0.2** | – |
| Impairment of intangible assets | | **–** | – |
| (Profit)/loss on sale of property, plant and equipment | | **(0.8)** | – |
| Operating lease rentals | | **14.2** | 15.3 |
| Financial Services Compensation Scheme Levies | 14 | **20.5** | 25.3 |
| Property provisions for liabilities and charges provided in the period | 14 | **(2.8)** | 1.9 |
| Other provisions for liabilities and charges provided in the period | 14 | **1.1** | 2.7 |
| Other provisions for liabilities and charges released during the period | 14 | **–** | (0.6) |
| Direct expenses from investment properties that generated rental income in the period | | **–** | 4.0 |
| Direct expenses from investment properties that did not generate rental income in the period | | **–** | 0.1 |

The following items are included in operating expenses, which have been incurred outside the ordinary course of business:

| | Note | Period to 30 June 2015 | Restated Period to 30 June 2014 |
|---|---|---|---|
| Investment, integration and rationalisation costs | | **41.6** | 20.6 |
| Bank separation costs | | **6.4** | 6.7 |
| Impairment of property, plant and equipment | | **–** | 7.0 |

## 9. Staff costs

| | Period to 30 June 2015 | Period to 30 June 2014 |
|---|---|---|
| Wages and salaries | **85.8** | 88.5 |
| Social security costs | **7.9** | 7.7 |
| Pension costs: | | |
| Defined benefit plans | **2.1** | 3.3 |
| Defined contribution plans | **11.3** | 13.8 |
| Other staff costs | **59.4** | 33.2 |
| | **166.5** | 146.5 |

Our approach on long term incentive plans (LTIP) was disclosed in the 2014 Annual Report. In May 2015 at the AGM shareholders approved the Bank's 2015 Long-Term Incentive Plan and authorised the Remuneration Committee to bring the LTIP into effect. Awards under the 2015 LTIP were approved and granted by the Remuneration Committee in the period to 30 June 2015.

All amounts are stated in £m unless otherwise indicated

## 10. Income tax

| | Note | Period to 30 June 2015 | Restated Period to 30 June 2014 |
|---|---|---|---|
| **Current tax** | | | |
| Current period | | **33.4** | (5.3) |
| Prior period | | **–** | 1.5 |
| Total current tax | | **33.4** | (3.8) |
| **Deferred tax** | | | |
| Current period | 15 | **(4.3)** | (8.5) |
| Prior period | 15 | **(0.2)** | – |
| Total deferred tax | | **(4.5)** | (8.5) |
| Total tax charge/(credit) | | **28.9** | (12.3) |

In addition to the above, included within other comprehensive income is a current tax credit of £4.9m (30 June 2014 (as restated): current tax charge of £1.2m) and a deferred tax credit of £2.4m (30 June 2014 (as restated): tax credit of £2.3m).

Further information on deferred tax is presented in note 15. The tax on the Bank's loss before taxation differs from the theoretical amount that would arise using the corporation tax rate in the UK as follows:

| | Note | Period to 30 June 2015 | Restated Period to 30 June 2014 |
|---|---|---|---|
| Loss before taxation | 3 | **(204.2)** | (77.0) |
| Tax calculated at a rate of 20.25% (30 June 2014: 21.49%) | | **(41.4)** | (16.6) |
| Effects of: | | | |
| Unrecognised deferred tax | | **40.4** | 6.5 |
| Adjustment to group relief debtor | | **31.9** | – |
| Discount of group relief debtor | | **(3.6)** | (4.9) |
| Other differences | | **1.0** | (0.6) |
| Change in rate of deferred tax | | **0.7** | 0.5 |
| Adjustments to tax charge in respect of prior periods | | **(0.2)** | 1.5 |
| Depreciation of capital expenditure not qualifying for capital allowances | | **0.1** | 0.2 |
| Expenses not deductible for tax purposes | | **0.1** | 2.4 |
| Non-taxable income | | **(0.1)** | (1.3) |
| Total tax charge/(credit) | | **28.9** | (12.3) |

The comparatives for the period to 30 June 2014 have been restated as described in note 3. This resulted in an increase in unrecognised deferred tax of £6.8m. Amounts receivable from The Co-operative Group Limited for tax losses surrendered and changes in that amount are recorded as an adjustment to the tax expense. The group relief debtor adjustment has arisen as a result of a revised repayment profile provided by The Co-operative Group Limited.

All amounts are stated in £m unless otherwise indicated

# 11. a) Loans and advances to customers

| | As at 30 June 2015 | As at 31 December 2014 |
|---|---|---|
| Gross loans and advances | **22,855.4** | 25,917.3 |
| Less: allowance for losses | **(466.9)** | (539.9) |
| | **22,388.5** | 25,377.4 |

Loans and advances to customers as at 30 June 2015 reflects the Bank's £1.5bn inaugural whole structure securitisation through Warwick Finance One during May 2015. See notes 7 and 22 for further details.

Loans and advances to customers include £3,354.5m (31 December 2014: £7,899.6m) securitised under the Bank's securitisation and covered bond programmes. Securitised loans and advances to customers decreased during the period as a result of the inaugural whole structure securitisation through Warwick Finance One, in addition to the call of notes issued by various Bank controlled securitisation vehicles. The Bank remains exposed to substantially all of the risks and rewards of ownership of these assets. Included within deposits by banks are £10.0m (31 December 2014: £10.1m) of loans from external third parties and within debt securities in issue are £2,428.4m (31 December 2014: £2,876.5m) of fixed and floating rate notes, all secured on these mortgage assets.

See note 23 for details of significant disposals of loans and advances to customers post period end.

## Concentration of exposure

The Bank's exposure is virtually all within the UK. Further information on the concentration of exposure is included within the risk management disclosures.

## Allowance for losses on loans and advances

| | Core | | Non-core | | |
|---|---|---|---|---|---|
| | Individual | Collective | Individual | Collective | Total |
| **Period to 30 June 2015** | | | | | |
| At the beginning of the period | **4.5** | **110.0** | **396.3** | **29.1** | **539.9** |
| Release for the period | **(0.5)** | **5.0** | **(26.1)** | **(1.2)** | **(22.8)** |
| Amounts written back/(off) | **1.3** | **(4.7)** | **(42.1)** | **(2.6)** | **(48.1)** |
| Unwind of discount allowance | **–** | **(1.1)** | **(1.2)** | **–** | **(2.3)** |
| Interest charged on impaired loans | **–** | **–** | **0.2** | **–** | **0.2** |
| At the end of the period | **5.3** | **109.2** | **327.1** | **25.3** | **466.9** |

Core provisions are analysed in further detail below:

| | Core | | | | | | |
|---|---|---|---|---|---|---|---|
| | Retail | | BaCB | | Other[1] | | Total Core |
| | Individual | Collective | Individual | Collective | Individual | Collective | |
| **Period to 30 June 2015** | | | | | | | |
| At the beginning of the period | **1.0** | **107.3** | **1.4** | **2.2** | **2.1** | **0.5** | **114.5** |
| (Release)/charge for the period | **(0.7)** | **6.3** | **0.1** | **(1.2)** | **0.1** | **(0.1)** | **4.5** |
| Amounts written back/(off) | **1.3** | **(4.7)** | **–** | **–** | **–** | **–** | **(3.4)** |
| Unwind of discount allowance | **–** | **(1.1)** | **–** | **–** | **–** | **–** | **(1.1)** |
| At the end of the period | **1.6** | **107.8** | **1.5** | **1.0** | **2.2** | **0.4** | **114.5** |

1. Other relates to Unity Trust Bank.

All amounts are stated in £m unless otherwise indicated

## 11. a) Loans and advances to customers continued

Non-core provisions are analysed in further detail below:

| | Non-core | | | | |
|---|---|---|---|---|---|
| | Corporate | | Optimum | | Total |
| | Individual | Collective | Individual | Collective | Non-core |
| **Period to 30 June 2015** | | | | | |
| At the beginning of the period | **386.8** | **16.7** | **9.5** | **12.4** | **425.4** |
| Release for the period | **(23.5)** | **(0.9)** | **(2.6)** | **(0.3)** | **(27.3)** |
| Amounts written off | **(35.2)** | **–** | **(6.9)** | **(2.6)** | **(44.7)** |
| Unwind of discount allowance | **(1.2)** | **–** | **–** | **–** | **(1.2)** |
| Interest charged on impaired loans | **0.2** | **–** | **–** | **–** | **0.2** |
| At the end of the period | **327.1** | **15.8** | **–** | **9.5** | **352.4** |

| | Core | | Non-core | | |
|---|---|---|---|---|---|
| | Individual | Collective | Individual | Collective | Total |
| **Year to 31 December 2014** | | | | | |
| At the beginning of the year | 10.7 | 167.8 | 724.5 | 49.4 | 952.4 |
| Balances with debt collection agencies | – | 39.6 | – | – | 39.6 |
| Release for the year | (1.5) | (3.3) | (147.3) | (20.3) | (172.4) |
| Amounts written off | (4.6) | (89.9) | (174.4) | – | (268.9) |
| Unwind of discount allowance | (0.1) | (4.2) | (6.6) | – | (10.9) |
| Interest charged on impaired loans | – | – | 0.1 | – | 0.1 |
| At the end of the year | 4.5 | 110.0 | 396.3 | 29.1 | 539.9 |

Core provisions are analysed in further detail below:

| | Core | | | | | | |
|---|---|---|---|---|---|---|---|
| | Retail | | BaCB | | Other[1] | | Total |
| | Individual | Collective | Individual | Collective | Individual | Collective | Core |
| **Year to 31 December 2014** | | | | | | | |
| At the beginning of the year | 2.8 | 161.9 | 0.5 | 5.3 | 7.4 | 0.6 | 178.5 |
| Balances with debt collection agencies | – | 39.6 | – | – | – | – | 39.6 |
| (Release)/charge for the year | (1.3) | (0.1) | 1.3 | (3.1) | (1.5) | (0.1) | (4.8) |
| Amounts written off | (0.5) | (89.9) | (0.4) | – | (3.7) | – | (94.5) |
| Unwind of discount allowance | – | (4.2) | – | – | (0.1) | – | (4.3) |
| At the end of the year | 1.0 | 107.3 | 1.4 | 2.2 | 2.1 | 0.5 | 114.5 |

1. Other relates to Unity Trust Bank.

Non-core provisions are analysed in further detail below:

| | Non-core | | | | |
|---|---|---|---|---|---|
| | Corporate | | Optimum | | Total |
| | Individual | Collective | Individual | Collective | Non-core |
| **Year to 31 December 2014** | | | | | |
| At the beginning of the year | 698.4 | 40.0 | 26.1 | 9.4 | 773.9 |
| (Release)/charge for the year | (129.0) | (23.3) | (18.3) | 3.0 | (167.6) |
| Amounts written back/(off) | (176.1) | – | 1.7 | – | (174.4) |
| Unwind of discount allowance | (6.6) | – | – | – | (6.6) |
| Interest charged on impaired loans | 0.1 | – | – | – | 0.1 |
| At the end of the year | 386.8 | 16.7 | 9.5 | 12.4 | 425.4 |

All amounts are stated in £m unless otherwise indicated

## 11. b) Fair value adjustments for hedged risk

The Bank has entered into interest rate swaps that protect it from fair value changes of its portfolio of fixed rate mortgages due to interest rate movements. Changes in the fair values of these swaps are offset by changes in the fair values of the fixed rate mortgages.

| | **As at 30 June 2015** | As at 31 December 2014 |
|---|---|---|
| Gross fair value adjustments for hedged risk | **116.0** | 196.8 |
| Less: impairment provision | **(26.5)** | (48.3) |
| | **89.5** | 148.5 |

Movements on impairment provision on fair value adjustments for hedged risk are shown below:

| | **As at 30 June 2015** | As at 31 December 2014 |
|---|---|---|
| At the beginning of the period | **48.3** | 46.8 |
| (Release)/charge for the period | **(21.8)** | 1.5 |
| At the end of the period | **26.5** | 48.3 |

## 12. Investment securities

### a) Loans and receivables

| | **As at 30 June 2015** | As at 31 December 2014 |
|---|---|---|
| Loans and receivables: | | |
| Listed | **18.0** | 18.1 |
| Unlisted | **–** | – |
| | **18.0** | 18.1 |
| Less: allowance for losses | **–** | – |
| | **18.0** | 18.1 |

### b) Available for sale

| | **As at 30 June 2015** | As at 31 December 2014 |
|---|---|---|
| Available for sale: | | |
| Listed | **3,605.6** | 3,022.4 |
| Unlisted | **93.3** | 145.1 |
| | **3,698.9** | 3,167.5 |
| Less: allowance for losses | **–** | – |
| | **3,698.9** | 3,167.5 |
| Included in cash and cash equivalents | **–** | 115.0 |

All amounts are stated in £m unless otherwise indicated

## 12. Investment securities continued

### Impairment analysis of investment securities – available for sale

| | As at 30 June 2015 | As at 31 December 2014 |
|---|---|---|
| At the beginning of the period | – | 20.0 |
| Release for the period | – | (1.1) |
| Utilised during the period | – | (18.9) |
| Exchange adjustments | – | – |
| At the end of the period | – | – |

## c) Fair value through profit or loss

| | As at 30 June 2015 | As at 31 December 2014 |
|---|---|---|
| Fair value through profit or loss: | | |
| Listed | **1,065.0** | 1,236.9 |
| Unlisted | – | – |
| | **1,065.0** | 1,236.9 |
| Less: allowance for losses | – | – |
| | **1,065.0** | 1,236.9 |

## d) Analysis of investment securities by issuer

| | As at 30 June 2015 | As at 31 December 2014 |
|---|---|---|
| Investment securities issued by public bodies: | | |
| Government securities | **2,959.5** | 3,210.3 |
| Other public sector securities | **122.0** | 339.7 |
| | **3,081.5** | 3,550.0 |
| | | |
| Investment securities issued by other issuers: | | |
| Bank and building society certificates of deposits | **297.1** | 145.1 |
| | | |
| Other debt securities: | | |
| Other floating rate notes | **676.3** | 709.3 |
| Mortgage backed securities | **727.0** | 18.1 |
| | **1,403.3** | 727.4 |
| | **4,781.9** | 4,422.5 |

Other floating-rate notes (FRNs) relate to sterling denominated FRNs with maturities ranging from six months to seven years from the balance sheet date.

All amounts are stated in £m unless otherwise indicated

## 13. Customer accounts – capital bonds

| | As at 30 June 2015 | As at 31 December 2014 |
|---|---|---|
| Retail | **142.4** | 263.8 |

The capital bonds are fixed term customer accounts with returns based on the movement in an index (eg FTSE 100) over the term of the bond. They have been designated on initial recognition at fair value through profit or loss and are carried at fair value.

The fair values for the capital bonds are obtained on a monthly basis from the swap counterparties. These external valuations are reviewed independently using valuation software to ensure the fair values are priced on a consistent basis.

The maximum amount the Bank would contractually be required to pay at maturity for all the capital bonds is £142.9m (31 December 2014: £264.3m).

The Bank uses swaps to create economic hedges against all of its capital bonds. The gain on capital bonds in the income statement for the period is £20.6m (30 June 2014: £23.6m). However, taking into account changes in fair value of the associated swaps, the net impact to the income statement for the period is a loss of £0.1m (30 June 2014: loss of £0.3m).

## 14. Provisions for liabilities and charges

| Period to 30 June 2015 | Note | Property | FSCS levies | PPI | Conduct/ legal | Separation | Other | Total |
|---|---|---|---|---|---|---|---|---|
| At the beginning of the period | | **24.4** | **12.7** | **73.6** | **362.5** | **112.3** | **32.0** | **617.5** |
| Provided / (released) in the period: | | | | | | | | |
| Interest income | | **–** | **–** | **–** | **20.0** | **–** | **–** | **20.0** |
| Operating expense | 8 | **(2.8)** | **20.5** | **–** | **0.5** | **–** | **0.6** | **18.8** |
| Provision for customer redress | | **–** | **–** | **–** | **28.5** | **–** | **–** | **28.5** |
| Utilised during the period | | **(1.8)** | **–** | **(29.0)** | **(58.9)** | **(36.6)** | **(6.5)** | **(132.8)** |
| Transfer to liabilities associated with non-current assets held for sale | | **–** | **–** | **–** | **–** | **–** | **–** | **–** |
| Increase in discount on loans identified for disposal | | **–** | **–** | **–** | **–** | **–** | **–** | **–** |
| At the end of the period | | **19.8** | **33.2** | **44.6** | **352.6** | **75.7** | **26.1** | **552.0** |
| | | | | | | | | |
| Provisions were analysed as follows: | | | | | | | | |
| Amounts falling due within one year | | **13.3** | **21.4** | **26.2** | **328.9** | **52.6** | **20.3** | **462.7** |
| Amounts falling due after one year | | **6.5** | **11.8** | **18.4** | **23.7** | **23.1** | **5.8** | **89.3** |
| | | **19.8** | **33.2** | **44.6** | **352.6** | **75.7** | **26.1** | **552.0** |

| Year to 31 December 2014 | Note | Property | FSCS levies | PPI | Conduct/ legal | Separation | Other | Total |
|---|---|---|---|---|---|---|---|---|
| At the beginning of the year | | 23.1 | 13.3 | 133.8 | 304.6 | 39.4 | 35.5 | 549.7 |
| Provided/(released) in the year: | | | | | | | | |
| Interest income | | – | – | – | 48.0 | – | – | 48.0 |
| Operating expense | 8 | 2.1 | 24.4 | - | 4.4 | 94.5 | (1.3) | 124.1 |
| Provision for customer redress | | – | – | 5.0 | 43.8 | – | 3.5 | 52.3 |
| Utilised during the year | | (0.5) | (25.0) | (65.2) | (38.3) | (21.6) | (21.5) | (172.1) |
| Transfer to liabilities associated with non-current assets held for sale | | (0.3) | – | – | – | – | – | (0.3) |
| Increase in discount on loans identified for disposal | | – | – | – | – | – | 15.8 | 15.8 |
| At the end of the year | | 24.4 | 12.7 | 73.6 | 362.5 | 112.3 | 32.0 | 617.5 |
| Provisions were analysed as follows: | | | | | | | | |
| Amounts falling due within one year | | 12.6 | 12.7 | 60.0 | 349.9 | 89.5 | 31.6 | 556.3 |
| Amounts falling due after one year | | 11.8 | - | 13.6 | 12.6 | 22.8 | 0.4 | 61.2 |
| | | 24.4 | 12.7 | 73.6 | 362.5 | 112.3 | 32.0 | 617.5 |

The Directors consider conduct and legal and separation provisions a critical accounting judgement. Further details are provided in note 2.

## 14. Provisions for liabilities and charges continued

### Property

The Bank has a number of leasehold properties available for rent. Provisions are made when either the sub-lease income does not cover the rental expense or the property is vacant. The provision is based on the expected outflows during the remaining periods of the leases. In addition, dilapidation provisions are recorded to the extent that the Bank has incurred dilapidations and/or the dilapidation clause within the contract has been invoked.

### Financial Services Compensation Scheme (FSCS) levies

In common with other regulated UK deposit takers, the Bank pays levies to the FSCS to enable the FSCS to meet claims against it. During 2008 and 2009 claims were triggered against the FSCS in relation to a number of financial institutions. The compensation paid out to consumers is currently funded through loans from HM Treasury. The Bank will be liable to pay a proportion of the outstanding borrowings that the FSCS has borrowed from HM Treasury. Additionally, the Bank is obliged to pay its share of management expenses and compensation based upon the Bank's proportion of the total market protected deposits at 31 December of each year.

The term of these loans was interest only for the first three years, with the FSCS recovering the interest cost, together with its own ongoing management expenses, through annual management levies on its members. The initial three year term expired in September 2011, and under the renegotiated terms the interest rate was reset from 12 month LIBOR +30bps to 12 month LIBOR +100bps.

By virtue of it holding deposits protected under the FSCS scheme the Bank has an obligation to pay levies in respect of the interest cost for 2014/15 onwards. From 2013, the FSCS had also started to repay the principal of the Treasury loans and a further levy has been raised in 2014/15 and 2015/16 for the expected capital shortfall for these loans, so that they are fully repaid by March 2016. 2015/16 will be the third and final year that the FSCS will raise a levy to repay the capital of the non-Bradford & Bingley loans from HM Treasury. These are due for repayment on 31 March 2016. £363.0m and £299.0m has previously been levied in 2013/14 and 2014/15 respectively, to partially repay these loans. The Bank has provided £33.2m as at 30 June 2015 (31 December 2014: £12.7m) for its share of the levies raised by the FSCS. The Bank's interest levy provision calculation includes estimates of the total FSCS levy in each levy year and estimates of the Bank's market participation in each levy year. The provision includes £11.9m in respect of the 2014/15 interest levy and £11.8m in respect of the 2015/16 interest levy. The Bank has also provided £9.5m in respect of its share of the capital levy.

### Payment Protection Insurance (PPI)

Provisions have been made in respect of potential customer compensation claims relating to past sales of PPI. Claims are investigated on an individual basis and, where appropriate, compensation payments are made. For a number of years, the Bank, along with many other financial services providers, sold PPI alongside mortgage and non-mortgage credit products. The Bank stopped selling non-mortgage PPI in January 2009 and stopped selling mortgage PPI in March 2012.

The FSA issued a policy statement in August 2010, which amended the 'Disputes Resolution: Complaints' section of the FSA Handbook, setting out new rules for handling complaints, including complaints of PPI mis-selling. The Bank must comply with the policy statement which requires complainants to receive adequate redress and the Bank to deliver fair outcomes and treat customers fairly including non-complainants. No additional provision was made in the period ending 30 June 2015 (30 June 2014: £5.0m), in respect of the total expected cost to the Bank of carrying out this work and paying compensation, leaving the total provisions raised by the Bank unchanged at £352.0m. This is discussed in more detail in note 2, including the potential impact of a recent UK Supreme Court ruling (Plevin).

Refer to the Income Statement on page 61 for details relating to the change in presentation of provision amounts in relation to net interest income, net fee and commission income and operating expenses.

### Conduct/legal provisions

During the period the Bank provided an additional £20.0m (30 June 2014: £29.0m) in respect of customer redress due to breaches of the technical requirements of the Consumer Credit Act.

The £28.5m (30 June 2014: £9.6m) charged through potential customer redress consists of £9.9m in relation to Consumer Credit Act delivery costs, £16.8m in relation to Packaged Accounts redress and delivery costs, £3.9m net charge in respect of Mortgage redress provisions and a £2.1m net release relating to other provisions.

### Other

Included within operating expenses is £0.6m in relation to fraud on customer accounts. During December 2014 the Bank entered into a Sale and Purchase Agreement to dispose of a portfolio of performing loans and associated hedging derivatives not considered to be core assets to a third party. These assets will be derecognised in 2015 after the completion of the contract (see note 23 for partial post period end derecognition). In 2014 a constructive obligation in respect of the discount on the loans identified for disposal of £15.8m was recognised and of this £4.6m has been utilised in period to 30 June 2015.

All amounts are stated in £m unless otherwise indicated

## 15. Deferred tax

Deferred taxes are calculated on all temporary differences under the liability method using a tax rate of 20% (2014: 20%).

The movements on the deferred tax accounts are as follows:

| | Note | **Period to 30 June 2015** | | | Period to 31 December 2014 | | |
|---|---|---|---|---|---|---|---|
| | | **Deferred tax asset** | **Deferred tax liability** | **Total** | Deferred tax asset | Deferred tax liability | Total |
| Deferred tax at the beginning of the period | | **21.0** | **(84.0)** | **(63.0)** | 25.1 | (103.0) | (77.9) |
| Credited/(charged) to the income statement: | | | | | | | |
| Current period | | **(7.0)** | **11.3** | **4.3** | 5.5 | 19.0 | 24.5 |
| Prior period | | **–** | **0.2** | **0.2** | – | – | – |
| | | **(7.0)** | **11.5** | **4.5** | 5.5 | 19.0 | 24.5 |
| | | | | | | | |
| Credited/(charged) to other comprehensive income: | | | | | | | |
| Cash flow hedges | | **2.4** | **–** | **2.4** | (8.7) | – | (8.7) |
| | | **2.4** | **–** | **2.4** | (8.7) | – | (8.7) |
| | | | | | | | |
| Reclassified to assets held for sale | | **0.5** | **–** | **0.5** | (0.9) | – | (0.9) |
| | | | | | | | |
| Deferred tax at the end of the period | | **16.9** | **(72.5)** | **(55.6)** | 21.0 | (84.0) | (63.0) |

The deferred tax asset above includes an offset for those deferred tax liabilities that are permissible to be offset.

| | **As at 30 June 2015** | | As at 31 December 2014 | |
|---|---|---|---|---|
| | **Deferred tax asset** | **Deferred tax liability** | Deferred tax asset | Deferred tax liability |
| Deferred tax comprises: | | | | |
| Capital allowances on fixed assets and assets leased to customers | **9.5** | **–** | 12.1 | – |
| Fair value adjustments – The Co-operative Bank subsidiaries | **–** | **(64.3)** | – | (76.4) |
| Other temporary differences | **16.9** | **(8.2)** | 21.0 | (7.6) |
| Cash flow hedges | **(8.9)** | **–** | (11.5) | – |
| Unrealised appreciation on investments | **(0.6)** | **–** | (0.6) | – |
| | **16.9** | **(72.5)** | 21.0 | (84.0) |

Net deferred tax assets expected to be recoverable after one year are £16.9m (31 December 2014: £21.0m).

Other temporary differences for the Bank totalling £8.7m (31 December 2014: £13.4m) relate to temporary differences arising on consolidation adjustments where the recoverability is not dependent on the future performance of the Bank, and temporary differences in subsidiaries that are forecast to make future taxable profits.

The deferred tax liability of £64.3m (31 December 2014: £76.4m) relating to fair value adjustments is net of a deferred tax asset of £1.6m (31 December 2014: £3.2m).

The deferred tax charge/(credit) in the income statement comprises:

| | **Period to 30 June 2015** | Period to 30 June 2014 |
|---|---|---|
| Capital allowances on fixed assets and assets leased to customers | **2.6** | 6.6 |
| Fair value adjustments | **(12.1)** | (10.3) |
| Other temporary differences | **5.2** | (4.8) |
| Cash flow hedges | **(0.2)** | – |
| | **(4.5)** | (8.5) |

Deferred tax assets totalling £338.8m (31 December 2014: £297.5m) have not been recognised where doubt exists over the availability of sufficient future taxable profits. Deferred tax has not been recognised in respect of trading losses of £1,444.8m (with deferred tax of £289.0m), capital losses of £16.4m (with deferred tax of £3.3m), and other temporary differences of £232.5m (with deferred tax of £46.5m). Deferred tax assets of £40.4m (31 December 2014: £22.7m) in respect of the current period have not been recognised.

All amounts are stated in £m unless otherwise indicated

## 15. Deferred tax continued

Reductions in the UK corporation tax rate from 23% to 21% (effective from 1 April 2014) and 20% (effective from 1 April 2015) were substantively enacted on 2 July 2013. This will reduce the Bank's future current tax charge accordingly.

On 8 July 2015 the Chancellor of the Exchequer announced that the UK corporation tax rate is to decrease from 20% to 19% (effective from 1 April 2017) and 18% (effective from 1 April 2020), and also that a banking surcharge tax of 8% will be introduced that will apply to the Bank and certain subsidiaries (effective from 1 January 2016). The Chancellor's announcements were not enacted or substantively enacted at the balance sheet date and accordingly deferred tax as at 30 June 2015 has been calculated based on the enacted rate of 20% at the balance sheet date.

In the Finance Act 2015 enacted on 26 March 2015, new tax legislation restricts the proportion of banks' annual taxable profit that can be offset by certain carried forward tax losses. The restriction will take effect from 1 April 2015 and will apply to relevant tax losses arising prior to this date. There is no impact on current tax in the interim 30 June 2015 financial statements due to tax losses arising in the period. As the Bank has not recognised a deferred tax asset on carried forward tax losses there would be no impact on the tax balances in the financial statements for the period ended 30 June 2015.

## 16. Pensions

The Bank participates in two hybrid multi-employers schemes, consisting of defined benefit and defined contribution sections, and also operates a small unfunded scheme; only the Pace scheme is open to further contributions. Full details of the schemes are disclosed within the Bank's Annual Report and Accounts 2014.

### The Co-operative Pension Scheme (Pace)

The Bank continues to account for this multi-employer scheme on a defined contribution basis as defined within the Bank's Annual Report and Accounts 2014. The Pace scheme triennial valuation as at 4 April 2013 was completed on 21 July 2014. The funding shortfall for the entire scheme had increased from £248.0m per the previous triennial valuation as at 6 April 2010 to £600m as at 4 April 2013.

The latest funding shortfall position calculated by the scheme actuary on an approximate basis as at 31 May 2014 was £104.0m. The level of funding for the Pace scheme is agreed between The Co-operative Group and the Pace Trustee. The Co-operative Group agreed a recovery plan with the Trustee of the scheme to contribute £25.0m per annum over 5 years from 1 July 2014 to 30 June 2019 (inclusive) to repay the £104.0m deficit calculated on an approximate basis as at 31 May 2014. On 19 August 2014, the Bank agreed to meet 20% of the total Pace deficit contributions at that date for the period up to the date at which the separation of accrued Pace assets and liabilities is agreed between the Bank and The Co-operative Group. As at 30 June 2015, the Bank has contributed £5.0m in this regard and has made provision for a further £5.0m.

The latest funding shortfall position calculated by the scheme actuary on an approximate basis as at 31 May 2014 was £104m.

### Britannia Pension Scheme (Britannia Scheme)

The Pension Scheme liabilities comprise:

| | **Assets 30 June 2015** | Assets 31 December 2014 | **Liabilities 30 June 2015** | Liabilities 31 December 2014 | **Net 30 June 2015** | Net 31 December 2014 |
|---|---|---|---|---|---|---|
| **Britannia Pension Scheme** | **732.9** | 728.5 | **(688.0)** | (683.7) | **44.9** | 44.8 |
| Less asset Limitation (IFRIC 14) | **(44.9)** | (44.8) | **–** | – | **(44.9)** | (44.8) |
| | | | | | | |
| Britannia unfunded obligations | **–** | – | **(3.3)** | (3.3) | **(3.3)** | (3.3) |
| | **688.0** | 683.7 | **(691.3)** | (687.0) | **(3.3)** | (3.3) |

The Britannia Scheme is accounted for on a defined benefit basis in the Interim Financial Report 2015. Whilst the Britannia Scheme is in accounting surplus, this has not been recognised on the balance sheet in accordance with IFRIC 14. The Bank has however recognised a £3.3m liability (31 December 2014: £3.3m) in relation to the unfunded element of the Britannia Scheme.

The amounts recorded are as follows:

| | **Period to 30 June 2015** | 31 December 2014 |
|---|---|---|
| Present value of funded obligations | **(688.0)** | (683.7) |
| Present value of unfunded obligations | **(3.3)** | (3.3) |
| Asset limitations (IFRIC14) | **(44.9)** | (44.8) |
| Fair value of plan assets | **732.9** | 728.5 |
| Net retirement plan liability | **(3.3)** | (3.3) |

All amounts are stated in £m unless otherwise indicated

## **16. Pensions** continued

The amounts recognised in the income statement are as follows:

| | Period to 30 June 2015 | 31 December 2014 |
|---|---|---|
| Current service cost | **–** | – |
| Interest expense on Defined Benefit Obligation | **(12.5)** | (26.5) |
| Interest income on plan assets | **13.4** | 27.7 |
| Administrative expenses and taxes | **(0.9)** | (1.2) |
| | **–** | – |

Changes in the present value of the defined benefits obligation are as follows:

| | Period to 30 June 2015 |
|---|---|
| 31 December 2014 | **(683.7)** |
| Benefit payments from plan | **8.2** |
| Interest expense | **(12.5)** |
| 30 June 2015 | **(688.0)** |

Changes in the present value of the defined benefits obligation are as follows:

| | Period to 30 June 2015 |
|---|---|
| 31 December 2014 | **728.5** |
| Interest income | **13.4** |
| Benefit payments from plan assets | **(8.2)** |
| Administrative expenses paid from plan assets | **(0.8)** |
| Return on plan assets (excluding Interest income) | **–** |
| 30 June 2015 | **732.9** |

| | 30 June 2015 | 31 December 2014 |
|---|---|---|
| The principal assumptions used to determine the liabilities of the Britannia defined benefit scheme are: | | |
| Discount rate | **3.70%** | 3.70% |
| Rate of increase in salaries | **3.20%** | 3.20% |
| Future pension increases where capped at 5.0% per annum | **3.15%** | 3.15% |
| Future pension increases where capped at 2.5% per annum | **2.20%** | 2.20% |
| Life expectancy: | | |
| Female member currently aged 65 (current life expectancy) | **25.1** | 25.1 |
| Male member currently aged 65 (current life expectancy) | **22.9** | 22.9 |
| Female member currently aged 45 (life expectancy at age 65) | **27.5** | 27.5 |
| Male member currently aged 45 (life expectancy at age 65) | **25.2** | 25.2 |
| | | |
| The principal assumptions used to determine the net pension cost of the Britannia defined benefit scheme are: | | |
| Discount rate | **3.70%** | 4.45% |
| Rate of increase in salaries | **3.20%** | 3.60% |

The Scheme Actuary completed an actuarial triennial valuation of the Scheme as at 5 April 2011 which showed that the Britannia Scheme had a funding shortfall of £3.7m. CFSMS (the sponsoring employer) subsequently agreed to pay a lump sum of £3.7m to eliminate this shortfall. The latest funding shortfall position calculated by the scheme actuary as at 5 April 2013 was £61.3m. The 5 April 2014 Britannia Scheme triennial valuation is expected to be completed in October 2015. As at 30 June 2015 the Bank has no requirement to pay deficit contributions in respect of the Britannia Scheme.

### Bank (unfunded) pension scheme

The Bank has recognised a liability of £4.6m (31 December 2014: £4.7m) in relation to the Bank's unfunded pension scheme.

## 17. Contingent liabilities

Details of contingent liabilities and commitments at 31 December 2014 were disclosed in the 2014 Annual Report and Accounts. These included the following key areas: Commitments under operating leases, indemnification agreement, conduct issues, Consumer Credit Act issues, regulatory and other investigations, legal proceedings, mortgage securitisation representations and warranties, pensions, former Britannia Building Society pension scheme guarantee and tax treatment of separation.

In addition, the following areas have also been identified as detailed below:

### Warwick Finance One mortgage securitisation representations and warranties

In connection with the Bank's Warwick mortgage securitisation, the Bank makes various representations and warranties relating to the mortgage loans, which include ownership, compliance with legislation and origination procedures. If the representations and warranties are breached subject to any applicable materiality determination, the Bank may be required to repurchase the affected mortgage loans or in some circumstances pay compensation to the securitisation vehicle.

There is a risk that a number of the underlying matters giving rise to the conduct and legal provisions set out in note 14 could have given rise to breaches of such representations and warranties. Accordingly there is a risk that the Bank may be required to pay compensation or repurchase affected mortgage loans in amounts that may reduce the Bank's liquidity.

The Bank is unable to estimate the extent to which the matters described above will impact it or how future developments may have a material adverse impact on the Bank's net assets, operating results or cash flows in any particular period.

### Consumer Credit Act issues

The Bank's provision for Consumer Credit Act issues is set out in note 14; this is the Bank's best estimate of the liability based on detailed legal analysis of the technical requirements of the Consumer Credit Act. Such legal analysis by its nature involves judgement and assessment of the facts of particular circumstances. In the event that such legal analysis and judgements are determined to be wrong, the Bank could be exposed to a material additional liability. The nature of contingent liabilities relating to Consumer Credit Act issues which were disclosed in the 2014 Annual Report and Accounts remain broadly unchanged.

### Regulatory and other investigations

Details of contingent liabilities and commitments at 31 December 2014 relating to regulatory and other investigations were disclosed in the 2014 Annual Report and Accounts. These contingent liabilities and commitments remain broadly unchanged.

## 18. Related party transactions

### Parent, subsidiary and ultimate controlling party

The ownership structure of the Bank changed on 20 December 2013 as a result of the LME, and further changed as a result of a further share issue of £400m for existing shareholders at April 2014, after which, The Co-operative Banking Group owned 20.16%.

At 30 June 2015, the Bank is an associate of, and therefore a related party of, The Co-operative Group since it ultimately owns 20.16% of the Bank's ordinary shares, has the right to Bank Board representation and there are material transactions between the two entities.

The Bank has a significant relationship with The Co-operative Group. As part of the Recapitalisation plan and the Bank ceasing to be a wholly owned subsidiary of The Co-operative Group, the Bank entered into the following agreements and several other arrangements.

### Principles

The Co-existence Principles govern the use of trademarks containing 'Co-operative' or 'Co-op' and other associated trademarks owned by both parties. For more information about the Co-existence Principles see the Corporate Governance Report within the 2014 Annual Report and Accounts – Co-existence Principles and the use of the 'Co-op' brand.

### Intra-group Loan

On 4 November 2013, the Bank, The Co-operative Banking Group and the Co-operative Group Limited entered into an Intra-group Loan facility (the Intra-group Loan) whereby the Co-operative Group Limited made available to The Co-operative Banking Group Limited during 2014 a term loan facility of up to £313m to be utilised by way of advances. The maturity date of the loan facility is 27 July 2019.

The purpose of the Intra-group Loan was to support The Co-operative Banking Group's Undertaking to Pay the Bank the agreed 2014 capital commitment as a result of the LME, which was paid in full by December 2014.

# 18. Related party transactions continued

## Pensions Undertaking

On 4 November 2013, The Co-operative Group and the Bank entered into an undertaking whereby The Co-operative Group agreed with the Bank not to require the Bank to cease to participate in Pace in connection with the LME. The parties also agreed at the request of one of the parties to enter into good faith discussions to reach agreement on the separation of Pace and agree the Bank's proportion of employer contributions in Pace (and if not agreed, the matter will be referred to an independent third party). The Co-operative Group and the Bank have differing views as to the Pace liabilities properly attributable to the Bank. As such, good faith discussions have not concluded and no Pace separation terms have been agreed. The Bank has expressed an intention to conclude negotiations over its exposure, the scale of contributions and its role in the longer-term scheme. The aim is to conclude these discussions during 2016.

## IT and other services

The Bank and The Co-operative Group entered into an IT Costs Separation Agreement on 22 January 2015. In consequence of the Bank's IT outsourcing agreement with IBM for enterprise computing services, the Bank is not progressing the proposed revised IT Service Agreement (ITSA) and Professional Services Master Service Agreement (PSMSA) which were described in the 2013 Annual report and accounts. A number of service contracts under the PSMSA have now been terminated and services repatriated to the Bank, with the intention that all will be terminated by the end of Q1 2016 except pensions and membership.

Under the IT costs separation agreement, both CGL and CFSMS undertake to support activities for the separation of the Bank's IT infrastructure from the wider Co-operative Group's IT infrastructure, to enable the smooth transition to IBM. Further, CGL and CFSMS undertake that any notice to terminate the existing IT services agreement (in the case of CGL) and the CFSMS-Bank Framework Agreement (in the case of CFSMS) would not take effect prior to 31 December 2017 to give the Bank sufficient time to separate the Bank's IT infrastructure. The IT separation costs agreement also allocated the contributions to be made towards The Co-operative Group's own costs of keeping the wider Co-operative Group's existing IT infrastructure stable and operable during and following the Bank's separation of its IT infrastructure; to this end CBGL (as the parent of CFSMS) undertook to contribute a maximum of £95m towards such Co-operative Group costs, with the Bank to make a contribution of up to £25m, based on a formula in the event that the total cost of this Co-operative Group project falls between £76m and £120m.

## CFSMS transactions

CFSMS is a subsidiary of The Co-operative Banking Group and continues to undertake the provision of supplies and services on behalf of the Bank. Further details of the CFSMS - Bank Framework agreement are disclosed below.

## CFSMS-Bank Framework

On 16 February 2006, the Bank and CFSMS entered into the CFSMS-Bank Services Agreement pursuant to which CFSMS provides assets such as office equipment, materials and office space, other facilities and services, and consultants who act as secondees to the Bank. The Bank provides CFSMS with an indemnity for all liabilities, losses, damages, costs and expenses of any nature as a result of CFSMS entering into and performing the agreement in respect of the assets, services and personnel provided to the Bank.

The Bank and CFSMS commenced unwinding this arrangement during 2014 with the transfer of the employment of most staff to the Bank (see 'Transfer of Staff from CFSMS to Bank' below), the transfer of assets to the Bank (see 'Tangible and Intangible Assets' below) and the Bank entering in to numerous contracts with third party suppliers to replace those previously provided through CFSMS or the wider The Co-operative Group. These activities continue into 2015, in particular in respect of the Bank's transition of enterprise services to IBM. The Bank will continue to make use of CFSMS assets used by both the Bank and CISGIL until full IT separation takes place, which the IT Separation Costs Agreement envisages will be completed before the end of 2017. In the IT Separation Costs Agreement CFSMS undertakes that any notice given by CFSMS to terminate the CFSMS-Bank Framework Agreement would not take effect prior to 31 December 2017, to give the Bank sufficient time to separate the Bank's IT infrastructure.

## Tax loss share

As part of the negotiations relating to the separation of the Bank from The Co-operative Group, the Bank and The Co-operative Group also agreed terms relating to the surrender of group relief between the entities in the Bank's tax group and entities in The Co-operative Group tax group. A deed sets out the basis of the agreement by The Co-operative Group to take proactive steps to allow it to maximise its claim for tax losses from the Bank for the accounting periods to 31 December 2012 and 2013. The deed also addresses the terms of the payment by The Co-operative Group to the Bank for those tax losses. The June 2015 Interim Financial Report, which includes a group relief debtor of £77.1m (31 December 2014: £126.8m), have been prepared on a basis consistent with the deed. The Bank receives payment from The Co-operative Group when The Co-operative Group realises the benefit of the losses surrendered and at the corporation tax rate at which the benefit is realised.

All amounts are stated in £m unless otherwise indicated

## 18. Related party transactions continued

### Transfer of staff from CFSMS to Bank

As explained in relation to the CFSMS-Bank Framework above, from 16 February 2006 CFSMS provided consultants acting as secondees to the Bank. The employment of substantially all Bank dedicated staff provided under that arrangement was transferred to the Bank under the Transfer of Undertakings (Protection of Employment) Regulations, on 23 January 2014. The employment of a further tranche of IT security personnel took place in November 2014.

### IT Security Services Letter Agreement

Following the TUPE transfer of IT security personnel from CFSMS to the Bank in November 2014, the Bank entered into a letter agreement with CFSMS that regulated the terms on which certain IT security personnel would have transferred from CFSMS to the Bank, and the terms on which the Bank would provide an IT security service that the transferred IT security personnel used to provide, in relation to the IT infrastructure which the Bank and CFSMS share. This service is provided by a small number of people who are provided to CFSMS by way of secondment.

### Master Services Agreement (MSA) and Shared Finance Services Service Package

In March 2015, recognising that there may be additional services (other than IT security) that the Bank may have to provide to CFSMS on account of the TUPE transfers from CFSMS to the Bank, the Bank entered into a Master Services Agreement with CFSMS, which set out the framework terms and conditions under which the Bank would provide services back to CFSMS.

At the time of signature of the MSA, a Service Package for Shared Finance Services was also signed.

The MSA applies to 3 categories of services: (i) services identified from time to time in Service Packages, (ii) a list of "undocumented" services (these did not have to be defined to the same level of detail required by a Service Package), and (iii) new services that may from time to time be identified as being provided by the Bank to CFSMS.

### Tangible and intangible assets

A number of assets were originally purchased by CFSMS using funds advanced by the Bank and then provided to the Bank by CFSMS under the 2006 CFSMS-Bank Services Agreement referred to above. In 2013, the Directors of the Bank concluded these assets met the accounting criteria to be shown as assets for the Bank, and therefore reported them on the balance sheet. This is referred to in more detail in the 2013 Annual Report and Accounts. Legal title of these assets transferred to the Bank in 2014.

As part of the separation activity, in November 2014 the Bank purchased the legal title of all Bank specific assets held by CFSMS (shared assets remained with CFSMS) through an SPV called CBG Asset Management Limited. The carrying value of these assets on the balance sheet at 30 June 2015 is £112.7m (31 December 2014: £126.0m).

### Balances with The Co-operative Group

The tables below provide an analysis of balances with The Co-operative Group and its undertakings at 30 June 2015 and 31 December 2014 and their location within the Bank's balance sheet.

| | As at 30 June 2015 | | | |
|---|---|---|---|---|
| | Loans and advances to customers | Other assets | Customer accounts | Other liabilities |
| The Co-operative Group Limited | **1.0** | **77.1** | **(164.5)** | **–** |
| The Co-operative Banking Group Ltd | **–** | **–** | **(31.4)** | **–** |
| Subsidiaries of The Co-operative Banking Group Ltd | **–** | **26.1** | **(12.2)** | **(112.7)** |
| | **1.0** | **103.2** | **(208.1)** | **(112.7)** |

## 18. Related party transactions continued

| | As at 31 December 2014 | | | |
|---|---|---|---|---|
| | Loans and advances to customers | Other assets | Customer accounts | Other liabilities |
| The Co-operative Group | 51.0 | 127.1 | (163.7) | – |
| The Co-operative Banking Group Ltd | – | – | (55.5) | – |
| Subsidiaries of The Co-operative Banking Group Ltd | – | 35.7 | (27.3) | (126.0) |
| | 51.0 | 162.8 | (246.5) | (126.0) |

### Shareholder rights agreement

At the time of the capital raising in May 2014, the Bank entered into a Shareholder Rights Agreement with The Co-operative Group and a number of other investors. As at 30 June 2015, SP Coop Investments Ltd owns more than 10% of the Bank's ordinary shares and is therefore a related party of the Bank.

The Shareholder Rights Agreement grants certain rights to the shareholders including the right for each of Silverpoint and Perry Capital (which holds less than 10%) to nominate a Director for appointment to the Board for so long as it continues to own 5% or more of the Bank. In addition, the Shareholder Rights Agreement grants the right for one Director nominated under its terms to be appointed to a sub-committee of the Board to assess the feasibility of the Bank listing its ordinary shares on the London Stock Exchange (IPO Committee).

## 19. Share capital

| | **Period to 30 June 2015** | | Period to 31 December 2014 | |
|---|---|---|---|---|
| | **No. of shares (millions)** | **Share capital** | No. of shares (millions) | Share capital |
| **Allotted, called up and fully paid (ordinary shares of 5p each)** | | | | |
| At the beginning of the period | **451.5** | **22.6** | 250.0 | 12.5 |
| Issue of new ordinary shares | **–** | **–** | 200.5 | 10.0 |
| Issue of new bonus shares | **–** | **–** | 1.0 | 0.1 |
| At the end of the period | **451.5** | **22.6** | 451.5 | 22.6 |
| | | | | |
| Share premium account | | | | |
| At the beginning of the period | | **1,736.9** | | 1,359.8 |
| Issue of new ordinary shares | | **–** | | 377.2 |
| Issue of new bonus shares | | **–** | | (0.1) |
| At the end of the period | | **1,736.9** | | 1,736.9 |

The £400.0m capital raising completed in May 2014 resulted in an issuance of new ordinary share capital of £10.0m and a gross increase in share premium of £390.0m. Bonus shares of £0.1m were also issued. As part of the capital raising the Bank incurred transaction costs of £12.8m. These were offset against the gross share premium amount, giving a net increase in capital of £387.2m, of which £377.1m was recorded as share premium.

The number of ordinary shares in issue at 30 June 2015 was 451,456,510 (31 December 2014: 451,456,510). The ordinary shareholders have one vote for every share held.

All amounts are stated in £m unless otherwise indicated

# 20. Fair values of financial assets and liabilities

The fair values in this note are stated at a specific date and may be significantly different from the amounts which will actually be paid on the maturity or settlement dates of the instruments. The tables below analyse the balance sheet carrying values of financial assets and liabilities by classification.

| Balance sheet categories | Held for trading | Designated at fair value | Loans and receivables | Available for sale | Liabilities at amortised cost | Derivatives in a hedging relationship | Total |
|---|---|---|---|---|---|---|---|
| **As at 30 June 2015** | | | | | | | |
| **Assets** | | | | | | | |
| Cash and balances at central banks | – | – | 4,577.7 | – | – | – | 4,577.7 |
| Loans and advances to banks | – | – | 934.3 | – | – | – | 934.3 |
| Loans and advances to customers | 3.9 | 174.1 | 22,210.5 | – | – | – | 22,388.5 |
| Fair value adjustments for hedged risk | – | – | 89.5 | – | – | – | 89.5 |
| Investment securities | – | 1,065.0 | 18.0 | 3,698.9 | – | – | 4,781.9 |
| Derivative financial instruments | 171.8 | – | – | – | – | 175.2 | 347.0 |
| Equity shares | – | – | – | 2.6 | – | – | 2.6 |
| Other assets | – | – | 422.3 | – | – | – | 422.3 |
| **Total financial assets** | 175.7 | 1,239.1 | 28,252.3 | 3,701.5 | – | 175.2 | 33,543.8 |
| Non-financial assets | | | | | | | 469.3 |
| **Total assets** | | | | | | | 34,013.1 |
| | | | | | | | |
| **Liabilities** | | | | | | | |
| Deposits by banks | – | – | – | – | 714.7 | – | 714.7 |
| Customer accounts | – | – | – | – | 26,801.0 | – | 26,801.0 |
| Customer accounts – capital bonds | – | 142.4 | – | – | – | – | 142.4 |
| Debt securities in issue | – | – | – | – | 2,905.3 | – | 2,905.3 |
| Derivative financial instruments | 135.5 | – | – | – | – | 290.0 | 425.5 |
| Other borrowed funds | – | – | – | – | 446.4 | – | 446.4 |
| Other liabilities | – | – | – | – | 165.5 | – | 165.5 |
| **Total financial liabilities** | 135.5 | 142.4 | – | – | 31,032.9 | 290.0 | 31,600.8 |
| Non-financial liabilities | | | | | | | 659.3 |
| **Total liabilities** | | | | | | | 32,260.1 |
| Capital and reserves | | | | | | | 1,753.0 |
| **Total liabilities and equity** | | | | | | | 34,013.1 |

IAS 39 requires derivative financial instruments that are not in a hedging relationship to be classified as 'held for trading'; this definition differs from the definition of 'derivatives held for trading purposes' as shown in the Bank's 2014 Annual Report and Accounts.

The above fair values have been calculated in accordance with IFRS 13, which values assets individually rather than as a portfolio.

During 2015, there was a £1.5bn securitisation transaction with Warwick Finance 1. For further details see detailed financial review.

All amounts are stated in £m unless otherwise indicated

## 20. Fair values of financial assets and liabilities continued

| Balance sheet categories | Held for trading | Designated at fair value | Loans and receivables | Available for sale | Liabilities at amortised cost | Derivatives in a hedging relationship | Total |
|---|---|---|---|---|---|---|---|
| **As at 31 December 2014** | | | | | | | |
| **Assets** | | | | | | | |
| Cash and balances at central banks | – | – | 4,765.3 | – | – | – | 4,765.3 |
| Loans and advances to banks | – | – | 1,608.4 | – | – | – | 1,608.4 |
| Loans and advances to customers | 3.9 | 182.7 | 25,190.8 | – | – | – | 25,377.4 |
| Fair value adjustments for hedged risk | – | – | 148.5 | – | – | – | 148.5 |
| Investment securities | – | 1,236.9 | 18.1 | 3,167.5 | – | – | 4,422.5 |
| Derivative financial instruments | 250.6 | – | – | – | – | 220.1 | 470.7 |
| Equity shares | – | – | – | 2.8 | – | – | 2.8 |
| Other assets | – | – | 187.6 | – | – | – | 187.6 |
| **Total financial assets** | 254.5 | 1,419.6 | 31,918.7 | 3,170.3 | – | 220.1 | 36,983.2 |
| Non-financial assets | | | | | | | 599.7 |
| **Total assets** | | | | | | | 37,582.9 |
| | | | | | | | |
| **Liabilities** | | | | | | | |
| Deposits by banks | – | – | – | – | 615.4 | – | 615.4 |
| Customer accounts | – | – | – | – | 29,614.0 | – | 29,614.0 |
| Customer accounts – capital bonds | – | 263.8 | – | – | - | – | 263.8 |
| Debt securities in issue | – | – | – | – | 3,443.6 | – | 3,443.6 |
| Derivative financial instruments | 176.0 | – | – | – | - | 375.7 | 551.7 |
| Other borrowed funds | – | – | – | – | 196.4 | – | 196.4 |
| Other liabilities | – | – | – | – | 157.8 | – | 157.8 |
| **Total financial liabilities** | 176.0 | 263.8 | – | – | 34,027.2 | 375.7 | 34,842.7 |
| Non-financial liabilities | | | | | | | 725.7 |
| **Total liabilities** | | | | | | | 35,568.4 |
| Capital and reserves | | | | | | | 2,014.5 |
| **Total liabilities and equity** | | | | | | | 37,582.9 |

### 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 Bank, and the purposes for which they are held, are outlined below:

#### Loans and advances to customers and customer accounts

The provision of banking facilities to customers is the primary activity of the Bank, and loans and advances to customers and customer accounts are major constituents of the balance sheet. Loans and advances to customers include retail mortgages, corporate loans, credit cards, unsecured retail lending and overdrafts. Customer accounts include retail and corporate current and savings accounts.

#### Loans and advances to banks and investment securities

Loans and advances to banks and investment securities underpin the Bank's liquidity requirements and generate incremental net interest income. Held for trading instruments are held for economic hedging purposes only as the Bank does not have an active trading book.

#### Deposits by banks and debt securities in issue

The Bank issues medium term notes within an established euro medium term note programme and also issues certificates of deposit and commercial paper as part of its normal treasury activities.

All amounts are stated in £m unless otherwise indicated

## 20. Fair values of financial assets and liabilities continued

### Other borrowed funds

The Bank utilises a broad spread of long term wholesale funding in the form of fixed rate subordinated debt in addition to funding from ordinary share capital and retained earnings.

### Derivatives

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

The most frequently used derivative contracts are interest rate swaps, exchange traded futures and options, caps and floors, currency swaps and forward currency transactions. Terms and conditions are determined by using standard industry documentation. Derivatives are subject to the same market and credit risk control procedures as are applied to other wholesale market instruments and are aggregated with other exposures to monitor total counterparty exposure, which is managed within approved limits for each counterparty.

### Foreign exchange

The Bank undertakes foreign exchange dealing to facilitate customer requirements and to generate incremental income from short term trading in the major currencies. Structured risk and trading related risk are managed formally within position limits which are set by ALCO, to which authority is delegated by the Board.

## b) Valuation of financial assets and liabilities at fair value

The following tables analyse financial assets and liabilities carried at fair value by the three level fair value hierarchy defined as follows:

- Level 1 – Quoted market prices in active markets
- Level 2 – Valuation techniques using observable inputs
- Level 3 – Valuation techniques using unobservable inputs

| | Fair value at end of the reporting period using: | | | |
|---|---|---|---|---|
| **As at 30 June 2015** | **Level 1** | **Level 2** | **Level 3** | **Total** |
| **Non-derivative financial assets** | | | | |
| Held for trading: | | | | |
| Loans and advances to customers | – | 3.9 | – | 3.9 |
| Designated at fair value: | | | | |
| Loans and advances to customers | – | 168.0 | 6.1 | 174.1 |
| Investment securities | 1,065.0 | – | – | 1,065.0 |
| Available for sale financial assets: | | | | |
| Investment securities | 3,605.6 | 93.3 | – | 3,698.9 |
| Equity shares | 0.1 | 2.5 | – | 2.6 |
| **Derivative financial instruments** | – | 347.0 | – | 347.0 |
| **Non-financial assets** | | | | |
| Investment properties | – | – | 2.1 | 2.1 |
| **Total assets carried at fair value** | 4,670.7 | 614.7 | 8.2 | 5,293.6 |
| | | | | |
| **Non-derivative financial liabilities** | | | | |
| Designated at fair value: | | | | |
| Customer accounts – capital bonds | – | 142.4 | – | 142.4 |
| **Derivative financial instruments** | – | 425.5 | – | 425.5 |
| **Total liabilities carried at fair value** | – | 567.9 | – | 567.9 |

All amounts are stated in £m unless otherwise indicated

## 20. Fair values of financial assets and liabilities continued

| | Fair value at end of the reporting period using: | | | |
|---|---|---|---|---|
| **As at 31 December 2014** | Level 1 | Level 2 | Level 3 | Total |
| **Non-derivative financial assets** | | | | |
| Held for trading: | | | | |
| Loans and advances to customers | – | 3.9 | – | 3.9 |
| Designated at fair value: | | | | |
| Loans and advances to customers | – | 176.0 | 6.7 | 182.7 |
| Investment securities | 1,236.9 | – | – | 1,236.9 |
| Available for sale financial assets: | | | | |
| Investment securities | 3,022.5 | 145.0 | – | 3,167.5 |
| Equity shares | 0.1 | 2.7 | – | 2.8 |
| **Derivative financial instruments** | – | 470.7 | – | 470.7 |
| **Non-financial assets** | | | | |
| Investment properties | – | – | 2.1 | 2.1 |
| **Total assets carried at fair value** | 4,259.5 | 798.3 | 8.8 | 5,066.6 |
| | | | | |
| **Non-derivative financial liabilities** | | | | |
| Designated at fair value: | | | | |
| Customer accounts – capital bonds | – | 263.8 | – | 263.8 |
| **Derivative financial instruments** | – | 551.7 | – | 551.7 |
| **Total liabilities carried at fair value** | – | 815.5 | – | 815.5 |

The carrying values of financial instruments measured at fair value are determined in compliance with the accounting policies in note 1 and according to the following hierarchy:

### Level 1 – Quoted market prices in active markets

Financial instruments with quoted prices for identical instruments in active markets. The best evidence of fair value is a quoted market price in an actively traded market.

### Level 2 – Valuation techniques using observable inputs

Financial instruments with quoted prices for similar instruments in active markets or quoted prices for identical or similar instruments in inactive markets and financial instruments valued using models where all significant inputs are observable.

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

#### Loans and advances to customers

Loans and advances to customers include Corporate loans of £158.7m (31 December 2014: £164.7m) 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.

# 20. Fair values of financial assets and liabilities continued

### Derivative financial instruments

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

### Investment properties

Investment properties are carried at fair value. For those within Level 2 fair value is calculated by using recent valuations of individual assets within the portfolio, indexed linked to the balance sheet date using the relevant regional house price index where appropriate.

### Customer accounts – capital bonds

The estimated fair value of customer accounts – capital bonds is based on independent third party valuations using forecast future movements in the appropriate indices.

### Equity shares

Equity shares primarily relate to investments held in VocaLink Holdings Limited which are unquoted shares. The valuation of these shares is based on the Bank's percentage shareholding and the net asset value of the consolidated group according to its most recently published financial statements.

## Level 3 – Valuation techniques using unobservable inputs

This is used for financial instruments valued using models where one or more significant inputs are not observable.

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

### Loans and advances to customers

Loans and advances to customers include 25 year fixed rate mortgages of £6.1m (31 December 2014: £6.7m) which are fair valued through profit or loss using unobservable inputs. 25 year fixed rate mortgages are valued using future interest cash flows at the fixed customer rate and estimated schedule of customer repayments. Cash flows are discounted at a credit adjusted discount rate; the credit adjustment is based on the average margin of new long dated (five years or greater) fixed rate business written in the last six months, and subject to quarterly review. The eventual timing of future cash flows may be different from that forecast due to unpredictable customer behaviour, particularly on a 25 year product. The valuation methodology takes account of credit risk and has remained the same in 2015 (31 December 2014: £0.5m decrease). A reasonable change in the assumptions would not result in any material change in the valuation.

### Derivative financial instruments

Derivative financial instruments in the form of interest rate swaps have been entered into between the Bank and its subsidiaries, and external counterparties.

The purpose of the swaps is to convert the fixed and base rate linked revenue receipts of the pool of mortgage assets to the same LIBOR linked basis as the intercompany loan. Under this swap arrangement the Bank's subsidiaries pay to the swap counterparty, the monthly mortgage revenue receipts of the pool of assets and receives from the swap counterparty LIBOR plus a contractual spread on the same notional balance, the spread being sufficient to cover the intercompany loan and any expenses. The Bank has a 'back to back' swap that is the mirror image of the subsidiaries' swaps.

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

All amounts are stated in £m unless otherwise indicated

## 20. 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 period | Purchases and transfers in | Sales and transfers out | Income or expense including impairment | Fair value at the end of the period |
|---|---|---|---|---|---|
| **Period to 30 June 2015** | | | | | |
| Loans and advances to customers | **6.7** | **–** | **(0.6)** | **–** | **6.1** |
| Derivative assets | **–** | **–** | **–** | **–** | **–** |
| Derivative liabilities | **–** | **–** | **–** | **–** | **–** |
| Investment properties | **2.1** | **–** | **–** | **–** | **2.1** |
| | **8.8** | **–** | **(0.6)** | **–** | **8.2** |
| **Period to 31 December 2014** | | | | | |
| Loans and advances to customers | 8.7 | – | (1.5) | (0.5) | 6.7 |
| Derivative assets | 30.5 | – | (30.5) | – | – |
| Derivative liabilities | (61.2) | – | 61.2 | – | – |
| Investment properties | 6.2 | – | (4.3) | 0.2 | 2.1 |
| | (15.8) | – | 24.9 | (0.3) | 8.8 |

### 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 in note 1.

The table below sets out a summary of the carrying and fair values of:

- financial assets classified as loans and receivables; and
- financial liabilities classified as held at amortised cost,

unless there is no significant difference between carrying and fair values.

| | Core | | | | Non-core | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| **Carrying Value** | Retail | BaCB | Treasury | Total Core | Corporate CoAM | Optimum | Total Non-core | Unity Trust Bank | Unallocated & Statutory Adjustments | Total |
| **As at 30 June 2015** | | | | | | | | | | |
| **Financial Assets** | | | | | | | | | | |
| Loans and advances to banks | **–** | **–** | **891.9** | **891.9** | **–** | **–** | **–** | **42.4** | **–** | **934.3** |
| Loans and advances to customers | **13,900.1** | **549.6** | **–** | **14,449.7** | **2,899.5** | **4,680.1** | **7,579.6** | **181.2** | **–** | **22,210.5** |
| Fair value adjustments to hedged risk | **116.0** | **–** | **–** | **116.0** | **(26.5)** | **–** | **(26.5)** | **–** | **–** | **89.5** |
| Investment securities | **–** | **–** | **18.0** | **18.0** | **–** | **–** | **–** | **–** | **–** | **18.0** |
| Other assets | **–** | **–** | **–** | **–** | **–** | **–** | **–** | **–** | **422.3** | **422.3** |
| **Financial Liabilities** | | | | | | | | | | |
| Deposits by banks | **–** | **–** | **714.7** | **714.7** | **–** | **–** | **–** | **–** | **–** | **714.7** |
| Customer accounts | **22,802.4** | **2,828.9** | **–** | **25,631.3** | **356.9** | **–** | **356.9** | **812.8** | **–** | **26,801.0** |
| Debt securities in issue | **–** | **–** | **2,905.3** | **2,905.3** | **–** | **–** | **–** | **–** | **–** | **2,905.3** |
| Other borrowed funds | **–** | **–** | **446.4** | **446.4** | **–** | **–** | **–** | **–** | **–** | **446.4** |
| Other liabilities | **–** | **–** | **–** | **–** | **–** | **–** | **–** | **–** | **165.5** | **165.5** |

All amounts are stated in £m unless otherwise indicated

## 20. Fair values of financial assets and liabilities continued

| | Core | | | | Non-core | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| **Fair Value** | **Retail** | **BaCB** | **Treasury** | **Total Core** | **Corporate CoAM** | **Optimum** | **Total Non-core** | **Unity Trust Bank** | **Unallocated & Statutory Adjustments** | **Total** |
| **As at 30 June 2015** | | | | | | | | | | |
| **Financial Assets** | | | | | | | | | | |
| Loans and advances to banks | **–** | **–** | **891.9** | **891.9** | **–** | **–** | **–** | **42.4** | **–** | **934.3** |
| Loans and advances to customers | **14,080.5** | **532.3** | **–** | **14,612.8** | **2,716.3** | **3,946.6** | **6,662.9** | **181.2** | **–** | **21,456.9** |
| Fair value adjustments to hedged risk | **116.0** | **–** | **–** | **116.0** | **(26.5)** | **–** | **(26.5)** | **–** | **–** | **89.5** |
| Investment securities | **–** | **–** | **17.1** | **17.1** | **–** | **–** | **–** | **–** | **–** | **17.1** |
| Other assets | **–** | **–** | **–** | **–** | **–** | **–** | **–** | **–** | **422.3** | **422.3** |
| **Financial Liabilities** | | | | | | | | | | |
| Deposits by banks | **–** | **–** | **714.7** | **714.7** | **–** | **–** | **–** | **–** | **–** | **714.7** |
| Customer accounts | **22,808.7** | **2,830.5** | **–** | **25,639.2** | **356.9** | **–** | **356.9** | **812.8** | **–** | **26,808.9** |
| Debt securities in issue | **–** | **–** | **2,957.2** | **2,957.2** | **–** | **–** | **–** | **–** | **–** | **2,957.2** |
| Other borrowed funds | **–** | **–** | **480.0** | **480.0** | **–** | **–** | **–** | **–** | **–** | **480.0** |
| Other liabilities | **–** | **–** | **–** | **–** | **–** | **–** | **–** | **–** | **165.5** | **165.5** |

| | Core | | | | Non-core | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| **Carrying Value** | Retail | BaCB | Treasury | Total Core | Corporate CoAM | Optimum | Total Non-core | Unity Trust Bank | Unallocated & Statutory Adjustments | Total |
| **As at 31 December 2014** | | | | | | | | | | |
| **Financial Assets** | | | | | | | | | | |
| Loans and advances to banks | – | – | 1,292.3 | 1,292.3 | – | – | – | 316.1 | – | 1,608.4 |
| Loans and advances to customers | 14,611.3 | 618.3 | – | 15,229.6 | 3,432.5 | 6,356.2 | 9,788.7 | 172.5 | – | 25,190.8 |
| Fair value adjustments to hedged risk | 196.8 | – | – | 196.8 | (48.3) | – | (48.3) | – | – | 148.5 |
| Investment securities | – | – | 18.1 | 18.1 | – | – | – | – | – | 18.1 |
| Other assets | – | – | – | – | – | – | – | – | 187.6 | 187.6 |
| **Financial Liabilities** | | | | | | | | | | |
| Deposits by banks | – | – | 615.4 | 615.4 | – | – | – | – | – | 615.4 |
| Customer accounts | 25,466.7 | 2,842.2 | – | 28,308.9 | 557.4 | – | 557.4 | 747.7 | – | 29,614.0 |
| Debt securities in issue | – | – | 3,443.6 | 3,443.6 | – | – | – | – | – | 3,443.6 |
| Other borrowed funds | – | – | 196.4 | 196.4 | – | – | – | – | – | 196.4 |
| Other liabilities | – | – | – | – | – | – | – | – | 157.8 | 157.8 |

All amounts are stated in £m unless otherwise indicated

## 20. Fair values of financial assets and liabilities continued

| | Core | | | | Non-core | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| **Fair Value** | Retail | BaCB | Treasury | Total Core | Corporate CoAM | Optimum | Total Non-core | Unity Trust Bank | Unallocated & Statutory Adjustments | Total |
| **As at 31 December 2014** | | | | | | | | | | |
| **Financial Assets** | | | | | | | | | | |
| Loans and advances to banks | – | – | 1,292.3 | 1,292.3 | – | – | – | 316.1 | – | 1,608.4 |
| Loans and advances to customers | 14,600.3 | 601.5 | – | 15,201.8 | 3,167.5 | 5,113.1 | 8,280.6 | 175.2 | – | 23,657.6 |
| Fair value adjustments to hedged risk | 196.8 | – | – | 196.8 | (48.3) | – | (48.3) | – | – | 148.5 |
| Investment securities | – | – | 14.3 | 14.3 | – | – | – | – | – | 14.3 |
| Other assets | – | – | – | – | – | – | – | – | 187.6 | 187.6 |
| **Financial Liabilities** | | | | | | | | | | |
| Deposits by banks | – | – | 615.4 | 615.4 | – | – | – | – | – | 615.4 |
| Customer accounts | 25,478.0 | 2,842.6 | – | 28,320.6 | 557.4 | – | 557.4 | 747.7 | – | 29,625.7 |
| Debt securities in issue | – | – | 3,478.9 | 3,478.9 | – | – | – | – | – | 3,478.9 |
| Other borrowed funds | – | – | 223.2 | 223.2 | – | – | – | – | – | 223.2 |
| Other liabilities | – | – | – | – | – | – | – | – | 157.8 | 157.8 |

Key considerations in the calculation of fair values for loans and receivables and financial liabilities at amortised cost are as follows:

### Loans and advances to banks/deposits by banks

Loans and advances to banks include interbank placements and items in the course of collection.

The amortised cost value of all loans and advances to banks are deemed to be a close approximation of their fair value due to their short maturity. The estimated fair value of fixed interest bearing deposits is based on discounted cash flows using prevailing money market interest rates for debts with similar credit risk and remaining maturity.

### Loans and advances to customers

The fair value of loans and advances to customers is calculated by segmenting the overall balance into Retail, Optimum and Corporate.

#### i. Retail

Fixed rate loans and advances to customers are revalued to fair value based on future interest cash flows (at funding rates) and principal cash flows discounted using an appropriate market rate. The market rate applied in the calculation is the average market rate for new originations of mortgages with similar characteristics to the book of mortgages being valued. This rate is assumed to encompass the time value of money, plus a risk premium to account for the inherent uncertainty in the timing and amount of future cash flows arising from a book of mortgage assets.

Forecast principal repayments are based on redemption at the earlier of maturity or re-pricing date with some overlay for historical behavioural experience where relevant. The eventual timing of future cash flows may be different from the forecast due to unpredictable customer behaviour. It is assumed that there would be no other factors which market participants would take into account when assessing the fair value of the Retail mortgage assets. It is assumed there is no fair value adjustment required in respect of interest rate movement on standard variable rate mortgage assets, as the interest rate being charged is assumed to be equal to the market rate for those mortgage assets.

## 20. Fair values of financial assets and liabilities continued

### ii. Optimum

Fair values have been calculated using the future lifetime income approach. Under this approach, fair value is measured by determining discounted expected cash flows, derived using expected redemption profiles of the portfolio and discounting these cash flows at current market rates for products with similar characteristics and risk profiles. The current market rate used is assumed to encompass the time value of money, plus a risk premium to account for the inherent uncertainty in the timing and amount of future cash flows arising from a book of mortgage assets.

### iii. Corporate

As part of the implementation of the Bank's strategy for Non-core assets, certain assets have either already been sold after the period end or plans to sell are well advanced. For these assets, the fair value can therefore be determined from the actual sale price achieved or expected to be received.

For other corporate assets an expected cash flow income approach has been used. Under this approach, value is measured by determining expected cash flows, derived using redemption profiles, from the portfolio and then considering credit costs, funding costs and tax to derive equity cash flows which are discounted at an appropriate blended cost of capital. The blended cost of capital is taken as an average of quoted cost of capital of the six largest listed banks in the UK, as this is assumed to represent the rate at which market participants would discount the future cash flows of a portfolio of corporate loans when assessing the fair value of such a portfolio.

The fair value of loans and advances to customers in total is 96% of the carrying value as at 30 June 2015. The overall fair values are less than par primarily due to two main factors for Non-core loans in particular:

1. Customer interest rates are below the market rate at the balance sheet date until expected maturity or the re-pricing date, if earlier; and

2. Credit risk adjustments due to incurred and expected future credit losses.

### Investment securities

Fair value is based on available market prices. Where this information is not available, fair value has been estimated using quoted market prices for securities with similar credit, maturity and yield characteristics.

### Customer accounts

The estimated fair value of deposits with no stated maturity, which includes non-interest bearing deposits, is the amount repayable on demand. The estimated fair value of fixed interest bearing deposits and other borrowings without quoted market prices is based on future interest cash flows (at funding rates) and principal cash flows, discounted using an appropriate market rate.

### Debt securities in issue and other borrowed funds

The aggregate fair values are calculated based on quoted market prices where available. For those notes where quoted market prices are not available, fair value has been estimated using quoted market prices for securities with similar credit, maturity and yield characteristics. Quoted prices may be from inactive markets.

The fair value of debt securities in issue is significantly above the carrying value as a result of the carrying value being net of merger fair value adjustments. The carrying values of debt securities in issue are expected to increase as the merger fair value adjustments continue to unwind, as shown in the following section.

All amounts are stated in £m unless otherwise indicated

## 20. Fair values of financial assets and liabilities continued

### Unwind of merger fair value adjustments

On the merger of the Bank and Britannia Building Society in August 2009 an exercise was undertaken to fair value the respective assets and liabilities of Britannia Building Society. These fair value adjustments are unwound on an EIR basis over the effective lives of the assets and liabilities. As at 30 June 2015, the remaining merger fair value unwinds and the forecast unwind profiles can be summarised as follows:

| | Carrying amount at period end | Remaining merger fair value to be unwound at period end | Actual unwind for the 6 month period to 30 June 2015 | Forecast unwind | | | |
|---|---|---|---|---|---|---|---|
| | | | | 6 month period to 31 Dec 2015 | 2016 | 2017 | 2018+ |
| **As at 30 June 2015** | | | | | | | |
| **Assets** | | | | | | | |
| Loans and advances to customers | 22,388.5 | (34.3) | (10.6) | (1.7) | (3.4) | (3.1) | (26.1) |
| Fair value adjustment for hedged risk | 89.5 | (15.0) | (5.9) | (1.1) | (2.2) | (2.1) | (9.6) |
| Other | 11,535.1 | 23.4 | 3.0 | 2.2 | 4.4 | 4.4 | 12.4 |
| **Total assets** | 34,013.1 | (25.9) | (13.5) | (0.6) | (1.2) | (0.8) | (23.3) |
| **Liabilities** | | | | | | | |
| Debt securities in issue | 2,905.3 | (312.2) | (66.4) | (78.2) | (176.0) | (58.0) | – |
| Deferred tax liabilities | 72.5 | 64.3 | 12.1 | 16.3 | 36.6 | 12.0 | (0.6) |
| Other | 29,282.3 | – | – | – | – | – | – |
| **Total liabilities** | 32,260.1 | (247.9) | (54.3) | (61.9) | (139.4) | (46.0) | (0.6) |

A breakdown of the unwind on debt securities in issue held at merger is as follows:

| Issue name | Issue date | Contractural maturity date | Carrying amount at period end | Fair value at period end | Remaining merger fair value to be unwound at period end | Actual unwind for the 6 month period to 30 June 2015 | Forecast unwind | | |
|---|---|---|---|---|---|---|---|---|---|
| | | | | | | | 6 month period to 31 Dec 2015 | 2016 | 2017 |
| **As at 30 June 2015** | | | | | | | | | |
| Leek Finance Number Seventeen plc | April 2006 | June 2016 | 543.4 | 552.7 | 54.9 | 22.1 | 25.4 | 29.5 | – |
| Leek Finance Number Eighteen plc | October 2006 | December 2016 | 688.4 | 695.9 | 99.6 | 23.8 | 27.6 | 72.0 | – |
| Leek Finance Number Nineteen plc | April 2007 | June 2017 | 676.8 | 680.4 | 164.2 | 22.5 | 27.2 | 78.1 | 58.9 |
| **Total Leek Notes** | | | 1,908.6 | 1,929.0 | 318.7 | 68.4 | 80.2 | 179.6 | 58.9 |

Of which liabilities held internally within the Bank are as follows:

| Issue name | Carrying amount at period end | Fair value at period end | Remaining merger fair value to be unwound at period end | Actual unwind for the 6 month period to 30 June 2015 | Forecast unwind | | |
|---|---|---|---|---|---|---|---|
| | | | | | 6 month period to 31 Dec 2015 | 2016 | 2017 |
| **As at 30 June 2015** | | | | | | | |
| Internally Held Leek Notes | 543.4 | 534.5 | 6.5 | 2.1 | 2.0 | 3.6 | 0.9 |

All amounts are stated in £m unless otherwise indicated

## 20. Fair values of financial assets and liabilities continued

### Fair values of financial assets and liabilities which are not carried at fair value and bases of valuation

Fair values are determined according to the hierarchy set out on page 99.

| | Carrying value | Level 1 | Level 2 | Level 3 |
|---|---|---|---|---|
| **As at 30 June 2015** | | | | |
| **Financial assets** | | | | |
| Loans and receivables: | | | | |
| Loans and advances to banks | **934.3** | **–** | **934.3** | **–** |
| Loans and advances to customers | **22,210.5** | **–** | **–** | **21,456.9** |
| Fair value adjustment for hedged risk | **89.5** | **–** | **–** | **89.5** |
| Investment securities | **18.0** | **17.1** | **–** | **–** |
| **Financial liabilities** | | | | |
| Financial Liabilities at amortised cost: | | | | |
| Deposits by banks | **714.7** | **–** | **714.7** | **–** |
| Customer accounts | **26,801.0** | **–** | **26,808.9** | **–** |
| Debt securities in issue | **2,905.3** | **760.0** | **2,197.2** | **–** |
| Other borrowed funds | **446.4** | **–** | **480.0** | **–** |

The carrying amount is a reasonable approximation of fair value for the following assets and liabilities: loans and advances to banks, other assets, deposits by banks and other liabilities.

| | Carrying value | Level 1 | Level 2 | Level 3 |
|---|---|---|---|---|
| **As at 31 December 2014** | | | | |
| **Financial assets** | | | | |
| Loans and receivables: | | | | |
| Loans and advances to banks | 1,608.4 | – | 1,608.4 | – |
| Loans and advances to customers | 25,190.8 | – | – | 23,657.6 |
| Fair value adjustment for hedged risk | 148.5 | – | – | 148.5 |
| Investment securities | 18.1 | 14.3 | – | – |
| **Financial liabilities** | | | | |
| Financial Liabilities at amortised cost: | | | | |
| Deposits by banks | 615.4 | – | 615.4 | – |
| Customer accounts | 29,614.0 | – | 29,625.6 | – |
| Debt securities in issue | 3,443.6 | 789.1 | 2,689.8 | – |
| Other borrowed funds | 196.4 | – | 223.2 | – |

All amounts are stated in £m unless otherwise indicated

## 20. Fair values of financial assets and liabilities continued

### d) Fair value of transferred assets and associated liabilities

#### Securitisation vehicles

The beneficial ownership of the loans and advances to customers sold to securitisation vehicles by the subsidiaries of the Bank fail the derecognition criteria, and consequently, these loans remain on the balance sheets of the sellers. Each seller therefore recognises a deemed loan financial liability on its balance sheet and an equivalent deemed loan asset is held on each securitisation company's balance sheet. The deemed loans are repaid as and when principal repayments are made by customers against these transferred loans and advances.

The securitisation vehicles have issued fixed and floating rate notes which are secured on the loans and advances to customers. The notes are redeemable in part from time to time, such redemptions being limited to the net capital received from mortgagors in respect of the underlying assets.

The Bank retains substantially all of the risks and rewards of ownership. The Bank benefits to the extent to which surplus income generated by the transferred mortgage portfolios exceeds the administration costs of those mortgages. The Bank continues to bear the majority of credit risk of these mortgage assets.

The table below shows the carrying values and fair values of the assets transferred to securitisation vehicles and their associated liabilities. The carrying values presented below are the carrying amounts as recorded in the books of the subsidiary companies, some of these issued notes are held internally by the Bank and as such are not shown in the consolidated balance sheet of the Group.

| | Carrying amount of transferred assets not derecognised | Carrying amount of associated liabilities | Fair value of transferred assets not derecognised | Fair value of associated liabilities | Net fair value position |
|---|---|---|---|---|---|
| **As at 30 June 2015** | | | | | |
| Leek Finance Number Seventeen plc | **538.6** | **543.4** | **404.7** | **552.7** | **(148.0)** |
| Leek Finance Number Eighteen plc | **645.0** | **688.4** | **486.8** | **695.9** | **(209.1)** |
| Leek Finance Number Nineteen plc | **626.4** | **676.8** | **477.3** | **680.4** | **(203.1)** |
| Leek Finance Number Twenty plc | **–** | **–** | **–** | **–** | **–** |
| Leek Finance Number Twenty One plc | **–** | **–** | **–** | **–** | **–** |
| Leek Finance Number Twenty Two plc | **–** | **–** | **–** | **–** | **–** |
| Silk Road Finance Number One plc | **–** | **–** | **–** | **–** | **–** |
| Silk Road Finance Number Three plc | **402.9** | **409.5** | **375.9** | **412.3** | **(36.4)** |
| Cambric Finance Number One plc | **–** | **–** | **–** | **–** | **–** |
| Meerbrook Finance Number Eight plc | **502.1** | **499.1** | **495.3** | **497.1** | **(1.8)** |
| | **2,715.0** | **2,817.2** | **2,240.0** | **2,838.4** | **(598.4)** |

The above carrying amount of associated liabilities can be reconciled to debt securities in issue, as follows:

| | Carrying value |
|---|---|
| Carrying amount of associated liabilities as given above | **2,817.2** |
| Internally held fixed and floating rate notes | **(651.4)** |
| Loan facilities and subdebt not included in debt securities in issue | **(452.7)** |
| Non-securitised debt securities | **1,497.0** |
| Merger fair value adjustment | **(318.8)** |
| Other adjustments | **14.0** |
| **Debt securities in issue per financial liabilities** | **2,905.3** |

All amounts are stated in £m unless otherwise indicated

## 20. Fair values of financial assets and liabilities continued

Of the notes listed above, those held by the Bank are as follows:

| | Carrying amount of transferred assets not derecognised | Carrying amount of associated liabilities | Fair value of transferred assets not derecognised | Fair value of associated liabilities | Net fair value position |
|---|---|---|---|---|---|
| **As at 30 June 2015** | | | | | |
| Leek Finance Number Seventeen plc | **153.1** | **154.5** | **157.1** | **152.5** | **4.6** |
| Leek Finance Number Eighteen plc | **180.6** | **192.8** | **194.9** | **186.5** | **8.4** |
| Leek Finance Number Nineteen plc | **181.5** | **196.1** | **197.1** | **195.5** | **1.6** |
| Silk Road Finance Number Three plc | **106.3** | **108.0** | **108.8** | **107.2** | **1.6** |
| | **621.5** | **651.4** | **657.9** | **641.7** | **16.2** |

The above carrying value and fair value of assets held for each entity has been determined by applying the proportion of internally held liabilities.

Transferred assets include securitised gilts and loans and advances to customers that have not been derecognised by the seller. The associated liabilities include the fixed and floating rate notes, bank loans and intercompany loans that specifically relate to the funding for the assets securitised.

The difference between the fair value and carrying value of the mortgages that have been securitised within Leek 17, 18 and 19 is significantly higher than the fair value to carrying value difference for the associated liabilities. This is because it is expected that the notes will be repaid at par at the call date of the Leek liabilities whereas most of the mortgages will continue to be held on the Bank's balance sheet for a significant period after the notes have been repaid and these mortgages have an interest rate which is below the equivalent market rate at the balance sheet date for loans of a similar nature.

The securitisation vehicles receive cash daily in relation to the transferred loans and advances and semi-annually for the transferred gilts. These amounts are held within loans and advances to banks until the associated liabilities' payments are due. Payments are made quarterly for all associated liabilities except for the variable funding notes associated with the transferred gilts, which are paid semi-annually. The amounts held within loans and advances to banks are not included in the table above but will be used in part to cover the repayments made on the associated liabilities.

The following table provides the fair value of the transferred assets and associated liabilities for 2014.

| | Carrying amount of transferred assets not derecognised | Carrying amount of associated liabilities | Fair value of assets not derecognised | Fair value of associated liabilities | Net fair value position |
|---|---|---|---|---|---|
| **As at 31 December 2014** | | | | | |
| Leek Finance Number Seventeen plc | 554.0 | 581.5 | 403.1 | 585.9 | (182.8) |
| Leek Finance Number Eighteen plc | 662.9 | 724.2 | 485.0 | 722.9 | (237.9) |
| Leek Finance Number Nineteen plc | 642.9 | 712.8 | 473.6 | 710.9 | (237.3) |
| Leek Finance Number Twenty plc | 1,340.1 | 1,319.7 | 1,338.9 | 1,269.6 | 69.3 |
| Leek Finance Number Twenty One plc | 763.6 | 775.4 | 788.6 | 719.3 | 69.3 |
| Leek Finance Number Twenty Two plc | 351.1 | 366.4 | 365.3 | 341.7 | 23.6 |
| Silk Road Finance Number One plc | 1,126.0 | 1,135.6 | 1,126.0 | 1,130.4 | (4.4) |
| Silk Road Finance Number Three plc | 451.3 | 459.8 | 457.7 | 463.1 | (5.4) |
| Cambric Finance Number One plc | 883.4 | 902.0 | 986.2 | 878.3 | 107.9 |
| Meerbrook Finance Number Eight plc | 564.5 | 564.5 | 570.3 | 458.2 | 112.1 |
| | 7,339.8 | 7,541.9 | 6,994.7 | 7,280.3 | (285.6) |

All amounts are stated in £m unless otherwise indicated

## 20. Fair values of financial assets and liabilities continued

### Covered Bond Limited Liability Partnerships

Moorland Covered Bonds LLP was established as a result of a £1.4bn covered bond retained issuance. Loans and advances to customers of £1.9bn were transferred to Moorland Covered Bonds LLP. The transfer was funded by a loan of £1.4bn and capital contribution of £0.5bn. During October 2011 the £1.4bn loan was repaid. Following additional capital contribution repayment and on achieving Regulated Covered Bond status there was a public issuance of notes in November 2011 totalling £0.6bn. As a result of these changes, at the period end the Bank held a loan of £0.6bn (31 December 2014: £0.6bn) and a capital contribution of £0.7bn (31 December 2014: £0.7bn) with Moorland Covered Bonds LLP.

Moorland Covered Bonds LLP does not have ordinary share capital. The Bank's interest in Moorland Covered Bonds LLP is in substance no different from a wholly owned subsidiary and consequently it is fully consolidated in the Consolidated Bank accounts. The table below shows the carrying values and fair values of the assets transferred to the covered bond and their associated liabilities:

| | Carrying amount of transferred loans and advances to customers | Carrying amount of fixed and floating rate notes | Fair value of transferred loans and advances to customers | Fair value of fixed and floating rate notes | Net fair value position |
|---|---|---|---|---|---|
| **As at 30 June 2015** | | | | | |
| Moorland Covered Bonds LLP | **1,155.1** | **596.7** | **1,246.1** | **671.5** | **574.6** |
| | | | | | |
| As at 31 December 2014 | | | | | |
| Moorland Covered Bonds LLP | 1,092.1 | 596.5 | 1,084.9 | 671.5 | 413.4 |

### Assets pledged

Assets are pledged as collateral under repurchase agreements with other banks. These deposits are not available to finance the Consolidated Bank's day-to-day operations.

| | Carrying amount of assets not derecognised | Carrying amount of associated liabilities | Fair value of assets not derecognised | Fair value of associated liabilities | Net fair value position |
|---|---|---|---|---|---|
| **As at 30 June 2015** | | | | | |
| Investments securities sold under repurchase agreements | **660.3** | **610.0** | **657.6** | **610.0** | **47.6** |
| | | | | | |
| As at 31 December 2014 | | | | | |
| Investments securities sold under repurchase agreements | – | – | – | – | – |

All amounts are stated in £m unless otherwise indicated

## 21. Non-current assets classified as held for sale

### a) Assets classified as held for sale

| | Non-current assets | Disposal group | **As at 30 June 2015** | As at 31 December 2014 |
|---|---|---|---|---|
| Property, plant and equipment | – | 0.5 | **0.5** | 50.1 |
| Intangible assets | – | 0.3 | **0.3** | 0.3 |
| Loans and advances to customers | – | 246.3 | **246.3** | 323.4 |
| Cash and cash equivalents | – | 12.8 | **12.8** | 9.1 |
| Other receivables | – | 1.1 | **1.1** | 4.4 |
| | – | 261.0 | **261.0** | 387.3 |

### b) Liabilities directly associated with assets classified as held for sale

| | Disposal group | **As at 30 June 2015** | As at 31 December 2014 |
|---|---|---|---|
| Trade and other payables | 0.2 | **0.2** | 6.6 |
| Current tax liabilities | 0.5 | **0.5** | 1.0 |
| Provision for liabilities and charges | 0.3 | **0.3** | 0.3 |
| | 1.0 | **1.0** | 7.9 |

The non-current assets presented as held for sale relates to the sale of Britannia House, which has a carrying value of zero at 30 June 2015.

The disposal groups relate to two transactions which are expected to complete in 2015 and have been approved by management:

i) The proposed sale of Western Mortgage Services Limited (WMSL) shares or business as part of the Bank's outsourcing of its mortgage processing services for all its residential mortgages. This proposed transaction was announced by the Bank on 11 November 2014. Please see note 23 for more information; and

ii) The sale of a renewable energy asset portfolio.

Except for the renewable energy asset portfolio which is included in Corporate CoAM, all of the above disposal groups and held for sale assets are included within the Other Core segment in note 4.

## 22. Interests in unconsolidated structured entities

Warwick Finance Residential Mortgages Number One PLC meets the definition of an Unconsolidated Structured Entity under IFRS 12, Disclosure of Interest in Other Entities.

The assets in the table below represent the Bank's continuing involvement in securitisations where the Bank has transferred assets to an unconsolidated SPE, but has invested in some of the notes issued by the SPE. These notes are reported in Investment Securities – Available for Sale. The maximum exposure to loss is the carrying amount of the notes as at 30 June 2015.

| | Carrying amount of continuing involvement in statement of financial position | | Fair value of continuing involvement | | Maximum exposure to loss |
|---|---|---|---|---|---|
| | Assets £m | Liabilities £m | Assets £m | Liabilities £m | £m |
| **30 June 2015** | **702.6** | **–** | **702.6** | **–** | **702.6** |
| 31 December 2014 | – | – | – | – | – |

| | Gain or loss recognised at transfer date £m | Income/ (expenses) recognised in reporting period £m | Income/ (expenses) recognised cumulatively £m |
|---|---|---|---|
| **30 June 2015** | **0.9** | **1.8** | **1.8** |
| 30 June 2014 | – | – | – |

As well as the investment in the notes issued, the Bank also has a requirement to fund any conduct redress on the mortgages. The Bank has currently funded £4.2m however anything above/below this figure will be due from/back to the Bank.

The Bank has also performed an asset management role since the transfer of the assets as a wholly owned subsidiary of the Bank, Western Mortgages Services, has continued to act as the servicer for the mortgages. As at 30 June 2015, fees of £0.5m had been accrued for these services. On 1 August 2015 WMSL was sold – see note 23 for further details.

## 23. Post balance sheet events

It is a requirement of IAS 10 (Events after the balance sheet date) that this Financial Report reflects events arising after 30 June 2015. The following events have occurred between 30 June 2015 and 19 August 2015 (the date of approval of this Financial Report, and represent 'non-adjusting' post balance sheet events:

### Outsourcing of mortgage processing services

On 11 November 2014, the Bank entered into a non-binding letter of intent agreement with Capita plc in relation to the outsourcing of its mortgage processing services for all of its residential mortgage portfolios. Since 11 November 2014, the Bank has commenced investing in the outsourcing arrangement which has resulted in the Bank recognising intangible assets and prepayments as at 30 June 2015 and incurring expenses in the half year ending 30 June 2015.

On 1 August 2015, the Bank finalised this arrangement and entered into a binding agreement with Capita plc. The signing of this agreement on 1 August 2015 represents a "non adjusting" post balance sheet event. As part of the transaction:

- 100% of the shares in Western Mortgage Services Limited (WMS), a wholly owned subsidiary of the Bank, were transferred to Capita plc. A profit of £27.5m was generated on disposal, £5.8m of which recognised on the date of sale, with the remaining £21.7m being deferred and recognised over the term of the outsourcing arrangement with Capita plc. The profit on sale incorporates a deferred contingent consideration which is due to be received.
- Capita plc acquired the Bank's other mortgage processing and administration operations;
- Certain Bank staff servicing the mortgage portfolios were transferred to Capita plc; and
- Britannia House, a commercial property wholly owned by the Bank was sold to Capita plc. The terms of the sale included the leaseback of a part of the property to the Bank. The transaction has been recorded as a sale and operating leaseback arrangement which has resulted in derecognition of the property from the balance sheet of the Bank. A profit of £2.8m was recognised on disposal which was recognised in its entirety on the date of sale.

### Disposal of the Bank's renewable energy portfolio

On 10 December 2014 the Bank exchanged a Sale and Purchase contract with L1 Renewables Limited for the sale of a portfolio of renewable energy assets with a carrying value of £323.0m. The transaction was conditional upon gaining consent to the transfer from the underlying borrowers.

On 14 July 2015 the Bank successfully completed the sale of the first tranche of 5 loans to L1 Renewables Limited with an aggregate carrying value of £47.6m. On 30 July 2015 a further 12 loans with an aggregate carrying value of £71.7m (as at 30 July 2015) met the conditions for transfer and completion of the sale of such loans to L1 Renewables Limited is scheduled to take place on 26 August 2015.

On 19 August 2015, a further 4 loans with an aggregate carrying value of £52.4m (as at 19 August 2015) met the conditions for transfer and completion of the sale of such loans to L1 Renewables Limited is scheduled to take place on 26 August 2015.

# Glossary
## For the period ended 30 June 2015

The following glossary defines terminology used within the Bank's Interim Financial Report to assist the reader and to facilitate comparison with publications by other financial institutions:

| Terminology | Definition |
|---|---|
| Almost prime | Almost prime lending is lending to borrowers with very low levels of adverse credit history. |
| Arrears | Customers are said to be in arrears or non-performing when they are behind in fulfilling their obligations with the result that an outstanding loan is unpaid or overdue. Corporate customers may also be considered non-performing prior to being behind in fulfilling their obligations. This can happen when a significant restructuring exercise begins. |
| Automated Valuation Model (AVM) | A valuation model used specifically for low loan to value (LTV) remortgages. Performance of AVMs is monitored on a regular basis to ensure their ongoing accuracy. |
| Banking Group | The Co-operative Banking Group Ltd and its subsidiaries, which included the Bank until legal separation occurred on 20 December 2013. |
| Basel II | A statement of best practice issued by the Basel Committee on Banking Supervision, that defines the methods by which firms should calculate their regulatory capital requirements to retain enough capital to protect the financial system against unexpected losses. Basel II became law in the EU Capital Requirements Directive, and was implemented in the UK via the FSA Handbook. |
| Basel III | A strengthening of the requirements laid out in Basel II, to be phased into the Bank from 2014 ahead of full implementation by 2022. Basel III is implemented within the European Union (including the UK) through CRD IV. |
| Basis points (bps) | One hundredth of a percent (0.01%), so 100 basis points is 1%. Used in quoting movements in interest rates or yields on securities. |
| BIPRU | The prudential sourcebook for banks, building societies and investment firms which sets out the PRA's requirements for capital and liquidity. |
| BaCB (Business and Commercial Banking) | The core segment of the Bank which specialises in lending to businesses. |
| Buy-to-let | A commercial practice of buying a property to let to tenants, rather than to live in. |
| Capital bonds | Fixed term customer accounts with returns based on the movement in an index (eg FTSE 100) over the term of the bond. |
| Capital ratio | Total of Tier 1 capital plus Tier 2 capital, all divided by risk weighted assets. |
| Capital Requirements Directive (CRD IV) | This encompasses both the Capital Requirements Directive and Capital Requirements Regulation (CRR) as well as the PRA's Policy Statement PS7/13: Strengthening capital standards. CRD IV implements Basel III within the European Union (including the UK) and is a strengthening of the requirements laid out in Basel II. |
| Capital resources | Capital held, allowable under regulatory rules, less certain regulatory adjustments and deductions that are required to be made. Capital includes retained earnings, share premium and minority interests. |
| Carrying value | The value of an asset or liability as it appears in the balance sheet. For each asset or liability, the value is based on either of the amortised cost or fair value principles. |
| Certificates of deposit (CDs) | Debt issued by banks, savings and loan associations to individual investors with terms ranging from a few months to several years. Longer term CDs tend to bear a higher interest rate. At the expiration of the term, investors may (subject to penalties) withdraw both the principal and the accrued interest. |
| CFS Management Services Ltd (CFSMS) | CFS Management Services Ltd (CFSMS) provides supplies and services on behalf of subsidiary undertakings within the Co-operative Banking Group. |
| Charged off | When all economical avenues to recover an unsecured debt have been exhausted, the Bank permanently closes the loan account, ie it is charged off. This final step sits at the end of a time frame within which the Bank attempts to manage the debt's recovery and differs from a 'write down' in terms of its fixed position in time (see Write down). |
| Collateral | A borrower's pledge, usually a property, which acts as security for repayment of the loan (see Secured lending). |
| Collateralised swap | A swap, whose volatility is secured (collateralised) by way of exchanging cash deposits (see Swaps). |
| Colleague engagement | An internal survey, measuring the level of the Bank's employees' engagement. |
| Collectively assessed for impairment | Impairment is measured collectively where a portfolio comprises assets with a homogenous risk and where appropriate statistical techniques are available. |
| Commercial Paper | An unsecured promissory note issued to finance short term credit needs. It specifies the face amount paid to investors on the maturity date. |
| Commercial real estate | Commercial real estate includes office buildings, industrial property, malls, retail stores, shopping centres, multifamily housing buildings, warehouses, and industrial properties. |

| Terminology | Definition |
|---|---|
| Common Equity Tier 1 | A CRD IV regulatory measure of financial (capital) strength. Common Equity Tier 1 capital is the highest quality of capital and comprises share capital and associated share premium, and general reserves from retained profits. The book values of goodwill and intangible assets as well as other regulatory adjustments, including the full amount of expected loss over provisions, are deducted from Common Equity Tier 1 capital for the purposes of capital adequacy. |
| Conduct risk | The risk that the Bank's behaviours, offerings or interactions will result in unfair outcomes for customers. |
| Contagion risk | An international financial market term which describes a corrupting or harmful influence, spreading effects of shocks from one counterparty to another. |
| Co-operative Asset Management (CoAM) | The segment that comprises Non-core assets managed for run down or exit. |
| Co-operative Banking Group Limited (CBGL) | The Co-operative Banking Group Ltd and its subsidiaries, which included the Bank until legal separation occurred on 20 December 2013. |
| Core business | Lines of business that are consistent with the Bank's strategy and risk appetite. |
| Corporate core segment | The segment that comprises corporate banking, business banking and business services in line with the Bank's strategy and risk appetite. |
| Cost of risk | Impairment charges (amounts provided for non-performing loans) expressed as a percentage of average loans during the year. |
| Cost to income ratio | Operating expenses divided by operating income. |
| Counterparty | In any financial contract, the person or institution entering the contract on the opposite side of the transaction is called a counterparty. |
| Covered bonds | Debt securities backed by a portfolio of mortgages that are segregated from the issuer's other assets solely for the benefit of the holders of the covered bonds. The Bank issues covered bonds as part of its funding activities. |
| Credit default swap | An arrangement whereby the credit risk of an asset (the reference asset) is transferred from the buyer to the seller of protection. A credit default swap is a contract where the protection seller receives premium or interest related payments in return for contracting to make payments to the protection buyer upon a defined credit event. Credit events normally include bankruptcy, payment default on a reference asset or assets, or downgrades by a credit rating agency. |
| Credit impairment | Impairment charges on loans and advances to customers. |
| Credit risk | The current or prospective risk to earnings and capital arising from a borrower's failure to meet the terms of any contract with the Bank or their failure to perform as agreed. |
| Currency swap | An arrangement in which two parties exchange specific principal amounts of different currencies at inception and subsequently interest payments on the principal amounts. Often one party will pay a fixed rate of interest, while the other will pay a floating rate (though there are also fixed-fixed and floating-floating arrangements). At the maturity of the swap, the principal amounts are usually re-exchanged. |
| Credit valuation adjustments (CVAs) | Adjustments to the fair values of derivative assets to reflect the creditworthiness of the counterparty. |
| Customer deposits | Money deposited by all individuals and companies that are not credit institutions. Such funds are recorded as liabilities in the Bank's balance sheet under customer accounts or financial liabilities designated at fair value. |
| Customer funding ratio | Customer deposits divided by customer loans. This is the reverse equation of the customer loan to deposit ratio (see Customer loan to deposit ratio). |
| Customer loan to deposit ratio | Customer loans divided by customer deposits. This is the reverse equation of the customer funding ratio (see Customer funding ratio). |
| Debt securities in issue | Transferable certificates of indebtedness of the Bank to the bearer of the certificates. These are liabilities of the Bank and include certificates of deposit, commercial paper and fixed and floating rate notes. |
| Default | Circumstances in which the probability of default is taken at 100% for the purposes of the calculation of regulatory capital and compliance with Basel II. This is defined as when a borrower reaches a predefined arrears status where a borrower is considered unlikely to repay the credit obligation in full without the lender taking action. |
| Deleverage the balance sheet | Strategic reduction of the Bank's risk asset base leading to improved capital management. |
| Delinquency | A customer in arrears is also said to be in a state of delinquency. When a customer is in arrears, their 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. |

## For the period ended 30 June 2015

| Terminology | Definition |
|---|---|
| Effective interest rate method (EIR) | The method used to measure the carrying value of certain financial assets or liabilities and to allocate associated interest income or expense over the relevant period. |
| Encumbrance | Encumbrance is an impediment to use of assets, for example a claim against a property by another party. Encumbrance usually impacts the transferability of the asset and restrict its free use until the encumbrance is removed. |
| Ethical Policy | A method developed since 1992 by which the Bank engages with its customers in relation to ethics. |
| Eurozone | The geographical area containing countries whose economies function using the European single currency. |
| Expected charge off rate | The expected level of a portfolio's loans that may be written off as bad debt. |
| Expected loss | A measure of anticipated loss for exposures captured under an internal ratings based credit risk approach. The expected loss amount is the exposure from a potential default of a counterparty or dilution over a one year period to the amount outstanding at default. |
| Exposure at default (EAD) | A Basel II Pillar 1 parameter the amount estimated to be outstanding at the time of default – EAD calculated under the standardised approach is always reported post credit conversion factors and provisions. Under the IRB approach the EAD includes undrawn commitments after credit conversion factors. |
| External audit | An independent opinion, by an external firm, on the Bank and Company's financial statements. |
| External credit rating | A financial indicator of risk, assigned by credit rating agencies, to potential investors in the Bank. |
| Fair value adjustments | Fair value adjustments are the remaining balance sheet adjustments for the assets/liabilities acquired on the merger of the Bank and Britannia Building Society on 1 August 2009. |
| Fair value amortisation | The amortisation of the remaining interest risk related fair value adjustments for the assets/liabilities acquired on the merger of the Bank and Britannia Building Society on 1 August 2009 (see Interest rate risk). |
| Financial Conduct Authority (FCA) | The FSA was replaced as the UK's financial regulator on 1 April 2013 by two new regulatory bodies: the PRA and the FCA. The FCA is responsible for the regulation of conduct in retail, as well as wholesale, financial markets and the infrastructure that supports those markets. |
| Financial instruments | Any document with monetary value. Examples include cash and cash equivalents, but also securities such as bonds and stocks which have value and may be traded in exchange for money. |
| Financial Services Authority (FSA) | An independent non-governmental body, given statutory powers by the Financial Services and Markets Act 2000, which regulated the financial services industry. It was replaced as the UK's financial regulator on 1 April 2013 by the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA). |
| Financial Services Compensation Scheme (FSCS) | The UK's compensation fund of last resort for customers of authorised financial services firms. The FSCS may pay compensation to customers if a firm is unable, or likely to be unable, to pay claims against it, usually because it has stopped trading or has been declared in default. The FSCS is funded by the financial services industry. Every firm authorised by the PRA is obliged to pay an annual levy, which goes towards its running costs and compensation payments. |
| Floating rate notes (FRNs) | Investments with a variable interest rate. The adjustments to the interest rate are usually made every three to six months and are tied (or float) to a certain money market index. |
| Forbearance | The Bank, for reasons relating to the actual or apparent financial stress of a borrower, grants a concession whether temporarily or permanently to that borrower. A concession may involve restructuring the contractual terms of a debt (such as an extension of the maturity date or any weakening of the security structure or adjustment/non enforcement of covenants) or payment in some form other than cash, such as an equity interest in the borrower. |
| Foreclosure | The legal process by which a lender, eg the Bank, obtains a court order in order to terminate a borrower's equitable right of redemption. This legal action is required when a borrower has materially failed to comply with the agreed terms and conditions of the loan, eg by defaulting (see Forbearance). |
| Forward rate agreement | A legal contract, governing the terms and conditions of a forward or future, in which the buyer pays a fixed rate of interest to the seller in return for the seller's floating rate (see Forwards, Futures and Swaps). |
| Forwards | Non-standardised contracts, traded over the counter, between two parties to buy or sell financial instruments at a specified future time at a price agreed today (see Over The Counter). |
| Funding for Lending | The Bank of England and HM Treasury launched the Funding for Lending Scheme (FLS) on 13 July 2012. It is designed to boost lending to households and businesses. It works by allowing participating banks and building societies to borrow from the Bank of England for up to four years. As security against that lending, participating banks will provide assets, such as business or mortgage loans, to the Bank of England. Banks were able to borrow during the 18 months from 1 August 2012 until 31 January 2014. |
| 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. |

## For the period ended 30 June 2015

| Terminology | Definition |
|---|---|
| Gap | The Bank's net exposure to variable elements being managed within its market risk, eg interest rate movements (see Market risk). |
| Hedging | A technique used by the Bank to offset risks on one instrument by purchasing a second instrument that is expected to perform in the opposite way. |
| Impaired loans | Loans where the Bank does not expect to collect all the contractual cash flows or expects to collect them later than they are contractually due. |
| Impairment allowance | A loss allowance held on the balance sheet as a result of the raising of a charge against profit for the incurred loss inherent in the lending book. An impairment loss allowance may be either individual or collective. |
| Individual Capital Guidance (ICG) | The PRA's statement as to the regulatory capital it expects the Bank to hold. |
| Individual Liquidity Adequacy Assessment (ILAA) | The Bank's assessment of its liquidity risks, controls and quantification of liquid assets required to survive severe financial shocks through the use of stress tests prescribed by the PRA (see Liquidity risk). |
| Individual Liquidity Guidance (ILG) | A PRA guidance on the required amount and composition of the liquid assets buffer that should be held by a firm. This guidance arises once the firm's Individual Liquidity Adequacy Assessment (ILAA) has been conducted. |
| Individually assessed for impairment | Impairment is measured individually for assets that are individually significant. |
| Individually significant | Large value loans that exceed a balance threshold established by the Bank, above which it is deemed appropriate to impair accounts on an individual basis. |
| Interest rate risk | The variability in value borne by an interest bearing asset, such as a loan or a bond, due to variability of interest rates. In general, as rates rise, the price of a fixed rate bond will fall, and vice versa. |
| Internal audit | Internal audit is an independent, objective assurance and consulting activity designed to add value and improve an organisation's operations. It helps an organisation accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes. |
| 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 PRA permission. |
| Investment grade | A debt security, treasury bill or similar instrument with a credit rating measured by external agencies of AAA to BBB. |
| Legal separation | The process by which the Bank was legally separated from the Co-operative Group. |
| Leverage ratio | A CRD IV measure, calculated as the ratio of Tier 1 capital to total exposures. Total exposures include on-balance sheet items, off-balance sheet items and derivatives. The leverage ratio is a supplementary measure to the risk-based capital requirements and is intended to constrain the build-up of excess leverage in the banking sector. |
| Liability Management Exercise (LME) | The process by which the Bank successfully raised c.£1.2bn of capital in 2013. This was effected by the transfer of preference shares and extinguishment of multiple subordinated liabilities, followed by the recognition of a single tranche of subordinated debt. |
| LIBOR (London Interbank Offered Rate) | The interest rate participating banks offer to other banks for loans on the London market. |
| Lifetime expected loss | The losses that the Bank expects to incur over the lifetime of portfolios of mortgage assets which were acquired on merger with Britannia Building Society. This is different from expected loss (see Expected loss) which is based on assets expected to default in the next 12 months. |
| Limited Liability Partnership (LLP) | An LLP provides each of its individual partners protection against personal liability for certain partnership liabilities. |
| Liquid Asset Buffer (LAB) | A range of assets from which the Bank can manage its liquidity risk. These assets have relatively short maturity dates. |
| Liquidity and funding risk | The risk that the Bank's resources will prove inadequate to meet its liabilities as they contractually fall due or as a result of any contingent or discretionary cash outflows that may occur in times of stress. It arises from mismatch of timings of cash flows generated from the Bank's assets and liabilities (including derivatives). |
| Loan to value (LTV) | A ratio which expresses the amount of a mortgage as a percentage of the value of the property. The Bank calculates residential mortgage LTV on an indexed basis (the value of the property is updated on a quarterly basis to reflect changes in the house price index (HPI)). |
| Loss emergence period | The time taken, expressed in months, for a loss event on a loan to become observed by the Bank. |

## For the period ended 30 June 2015

| Terminology | Definition |
|---|---|
| Loss given default | An estimate of the actual loss that would occur in the event of default expressed as a percentage of the Exposure at Default (EAD). |
| Loss provisions | Provisions held against assets on the balance sheet as a result of the raising of a charge against profit for the incurred loss inherent in the lending book. The allowance represents management's best estimate of losses incurred in the loan portfolio at the balance sheet date. |
| Low to medium credit risk | Within not impaired, low to medium credit risk has been defined as exposures where the probability of default (PD) is 1% or below over a one year time horizon for exposures on an internal ratings based (IRB) approach under Basel II, and slotting category strong/good for specialised lending exposures under the slotting approach (see Slotting). |
| Lower Tier 2 | Lower Tier 2 capital comprises the Bank's long term subordinated debt. |
| Malus | A facility whereby the Remuneration Committee may reduce the amount of any deferred bonus payable in the event that any of the underpins to the incentive plans are not met or where business and/or individual performance otherwise requires. |
| Management expenses and compensation cost | The specific elements of both operating and financing cost which form the basis of the Financial Services Compensation Scheme (see Financial Services Compensation Scheme (FSCS)). |
| Mandatory reserve deposits | Mandatory reserve deposits are deposited with the Bank of England and are not available for use in the Bank's day to day operations. They are non-interest bearing and are not included in cash and cash equivalents. |
| Market risk | Risk that the values of assets and liabilities, earnings and/or capital may change as a result of changes in market prices of financial instruments. The majority of the Bank's market risk arises from changes in interest rates. |
| Medium term notes (MTN) | Flexible medium term corporate debt instruments, offered by the Bank to investors through a dealer. Investors can choose from differing maturities, ranging from nine months to 30 years. |
| Medium to high credit risk | Within not impaired, medium to high credit risk has been defined as a probability of default (PD) of greater than 1% over a one year time horizon for exposure on internal ratings based (IRB) approach under Basel II, and slotting category weak/satisfactory for specialised lending exposures under the slotting approach (see Slotting). |
| Merger | Any combination of two or more business enterprises into a single enterprise. In the Bank, this specifically refers to the merger of the Bank with Britannia Building Society on 1 August 2009 (see Transfer of engagements). |
| Mortgage backed securities | Securities that represent interests in a group of mortgages. Investors in these securities have the right to cash received from future interest and/or principal mortgage payments. |
| Multilateral Development Banks (MDBs) | Supranational institutions which provide financial support and professional advice for economic and social development activities in developing countries. The term MDBs typically refers to the World Bank Group and Regional Development Banks. |
| Net interest income | The difference between interest received on assets and interest paid on liabilities after taking into account the effect of derivatives. |
| Net present value (NPV) | The present value of the expected future cash in and out flows on an asset or liability. |
| Non-conforming | Loans that do not conform to regular credit standards at origination. |
| Non-core business | Lines of business not congruent with the Bank's current strategy, are managed for value and are targeted for run down and exit, and contain the majority of impairment risk. Included in Non-core is Corporate Non-core business, Optimum (closed book of residential mortgages originated through intermediaries and previously purchased mortgage portfolios) and Illius (the residential property company). |
| Operational risk | The risk of loss resulting from inadequate or failed internal processes, people and systems or external events. This encompasses the effectiveness of risk management techniques and controls to minimise these losses. |
| Optimum | A sub-segment within CoAM which is a closed book of residential mortgages originated through intermediaries and previously purchased mortgage portfolios. |
| Options | Instruments which convey the rights, but not the obligations, to engage in future transactions. |
| 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. |
| Pension risk | The risk to Bank capital and Company funds from exposure to pension scheme liabilities and risks inherent in the valuation of scheme liabilities and assets. |
| Preference shares | The preference shares are fixed interest shares, non-cumulative and irredeemable. |

## For the period ended 30 June 2015

| Terminology | Definition |
|---|---|
| Prime | Prime mortgages are mainstream residential loans, which typically have a higher credit quality and fit standard underwriting processes. As such, they are likely to have a good credit history and pass a standard affordability assessment at the point of origination. |
| Probability of default (PD) | The likelihood that a loan will not be repaid and will fall into default. PD may be calculated for each customer who has a loan (normally applicable to wholesale customers) or for a portfolio of customers with similar attributes (normally applicable to retail customers). To calculate PD, the Bank assesses the credit quality of borrowers and other counterparties and assigns them an internal risk rating. |
| | Bonds with no maturity date that do not require the issuer to redeem. |
| Project Verde | The bid to purchase the Verde business from the Lloyds Banking Group. Also referred to as Project Mars. |
| Prudential Regulation Authority (PRA) | The FSA was replaced as the UK's financial regulator on 1 April 2013 with two new regulatory bodies: the PRA and the FCA. The PRA, a subsidiary of the Bank of England, is responsible for promoting the stable and prudent operation of the financial system through regulation of all deposit-taking institutions, insurers and investment banks. |
| Recapitalisation Plan | The process by which the Bank is improving its capital position in line with regulatory guidance. |
| Recovery and Resolution Plan | The FSA required all UK deposit takers and large investment firms to draw up a Recovery and Resolution Plan by 31 December 2012. The Recovery Plan assesses and documents the recovery options available in situations of financial stress or negative financial shocks, either market-wide or idiosyncratic. The Resolution Plan will provide authorities with sufficient information to enable them to determine a detailed roadmap to resolve a failed financial institution, without resorting to government (effectively taxpayer) support. |
| Remuneration Code | The Remuneration Code, issued by the Financial Services Authority, sets out the standards that banks, building societies and other financial institutions have to meet when setting pay and bonus awards for their staff. It aims to ensure that firms' remuneration practices are consistent with effective risk management. |
| Repo/Reverse repo | A repurchase agreement that allows a borrower to use a financial security as collateral for a cash loan at a fixed rate of interest. In a repo, the borrower agrees to sell a security to the lender subject to a commitment to repurchase the asset at a specified price on a given date. For the party selling the security (and agreeing to repurchase it in the future) it is a repo; for the party on the other end of the transaction (buying the security and agreeing to sell in the future) it is a reverse repurchase agreement or reverse repo. |
| Reputational risk | The risk associated with an issue which could in some way be damaging to the brand of the Bank either through its strategic decisions, business performance, an operational failure or external perception. |
| Retail segments | The Core and Non-core segments that comprise customer focused products and services for individuals, sole traders and small partnerships. This includes mortgages, credit cards, consumer loans, current accounts and savings products. |
| Return on Equity | The ratio of profit for the year (after tax) to shareholders equity, expressed as a percentage. |
| Return on Risk Weighted Exposure Amount (RRWEA) | The return on Bank's assets and exposures weighted according to risk. The measure is one of the performance metrics set by the Remuneration and Appointments Committee when assessing targets in the long term incentive plan. |
| Risk appetite | The articulation of the level of risk that the Bank is willing to accept (or not accept) in order to safeguard the interests of the members whilst achieving its business objectives. |
| Risk weighted amount | Risk weightings are established in accordance with Basel II as implemented by the FSA. Risk weighted amounts are the carrying value of the Bank's assets, adjusted by the risk weightings, to reflect the degrees of risk they represent. |
| Risk weighted assets | A measure of a bank's assets adjusted for their associated risks. Risk weightings are established in accordance with Basel II. |
| Secondary sovereign exposure | Direct exposure to something other than sovereign debt that has itself a direct exposure to sovereign debt. |
| Secured lending | Lending in which the borrower pledges retail or commercial property as collateral for the loan, which then becomes a secured debt owed to the Bank. In the event that the borrower defaults, the Bank may take possession of the asset used as collateral and may sell it to regain some or the entire amount originally lent to the borrower. |
| Securitisation | A process by which a portfolio of retail mortgages is used to back the issuance of new securities by an SPE. The Bank has established securitisation structures as part of its funding and capital management activities (see Special purpose entities (SPEs)). |
| Senior unsecured debt | Debt that has priority ahead of all other unsecured or subordinated debt for payment in the event of default. |

## For the period ended 30 June 2015

| 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:<br>• 'Standardised' businesses lack sufficient information upon which detailed credit analysis can be undertaken for which models have yet to be developed;<br>• 'Strong' businesses have little competition, high demand, significant governmental support and enforceable collateral;<br>• 'Good' businesses have limited competition, stable demand, good governmental support and enforceable collateral;<br>• 'Satisfactory' businesses have a broad competition base with limited levels of demand, governmental support and collateral;<br>• 'Weak' businesses operate at a disadvantage to competition, display a declining trend of demand, with no governmental support and no clear collateral; and<br>• 'Default' businesses are considered unlikely to repay their credit obligations (see Impaired loans). |
| SME customers | Small and medium sized businesses engaging with the Bank as customers. |
| SONIA | Sterling OverNight Index Average (SONIA). Yield curves used by the Bank for swap arrangements. These are based on overnight indexed rates. |
| Sovereign debt | Bonds issued by and loans given to central banks and local governments, governmental bodies and other government-related bodies. |
| Sovereign exposure | The Bank's exposure to the total financial obligations incurred by all governmental bodies of any nation. |
| Special purpose entities (SPEs) | Entities that are created to accomplish a narrow and well defined objective. For the Bank this includes:<br>• various securitisation transactions in which mortgages were sold to SPEs. The equity of these SPEs is not owned by the Bank; and<br>• Covered Bond Limited Liability Partnerships created in order to act as guarantors for issues of covered bonds. |
| Specialised lending | Lending in which the primary source of repayment of the obligation is the income generated by the assets being financed, rather than the independent capacity of a broader commercial enterprise. |
| Standardised category | Customers who have not defaulted, and for the purposes of the capital calculations are not rated with the regulatory approved rating model. |
| Standard Variable Rate (SVR) | A variable and basic rate of interest charged on a mortgage. This may change in reaction to market conditions resulting in monthly repayments going up or down. |
| Statutory loss | The loss stated in accordance with the requirements of the UK Companies Act 2006, which incorporates the requirements of International Financial Reporting Standards (IFRS). |
| Strategic Asset Review | The process by which the Bank centrally monitors risk on its corporate loan assets in line with agreed strategy and governance parameters. |
| Strategic and business risk | Risk arising from changes to the Bank's business and the environment in which it operates, specifically the risk of not being able to carry out the Bank's business plan and desired strategy. |
| Subordinated debt/liabilities | Liabilities which, in the event of insolvency or liquidation of the Bank, are subordinated to the claims of depositors and other creditors of the Bank. |
| Swaps | An agreement between the Bank and a counterparty in which one stream of future payments is exchanged for another stream, based on a specified principal amount. For example, interest rate swaps often involve exchanging a fixed receipt for a floating receipt, which is linked to an interest rate (most often LIBOR). The Bank's use of swaps helps to manage periodic market risk on its financial instruments. |
| Term deposit | A deposit balance that cannot be withdrawn before a date specified at the time of deposit. |
| the Bank | The Co-operative Bank and its subsidiaries. |
| the Banking Group | See 'the Co-operative Banking Group'. |
| the Board | The Board of Directors. They manage the Bank's business performance in line with its purpose, givens, vision and values. |
| the Company | The Co-operative Bank as a standalone entity. |
| the Co-operative Banking Group | The Co-operative Banking Group Ltd and its subsidiaries, which included the Bank until legal separation occurred on 20 December 2013. |

## For the period ended 30 June 2015

| Terminology | Definition |
|---|---|
| The Co-operative Group | The former ultimate parent company of the Bank, pre legal separation. |
| Tier 1 | A regulatory measure of financial (capital) strength. Tier 1 is divided into Core Tier 1 and other Tier 1 capital. Core Tier 1 capital comprises share capital and associated share premium, and general reserves from retained profits. The book values of goodwill and intangible assets are deducted from Core Tier 1 capital and other regulatory adjustments may be made for the purposes of capital adequacy. Qualifying capital instruments such as perpetual subordinated bonds are included in other Tier 1 capital. |
| Tier 1 ratio | Tier 1 capital divided by risk weighted assets. |
| Tier 2 | Tier 2 capital comprises the Bank's property valuation reserve, preference shares, qualifying subordinated notes and collective impairment allowance (for exposures treated on a Basel II standardised basis). Certain regulatory deductions may be made for the purposes of assessing capital adequacy. |
| Transfer of engagements | On 1 August 2009, Britannia Building Society merged with The Co-operative Bank plc by a transfer of engagements between the Building Society and the Bank under the Building Societies (Funding) and Mutual Societies (Transfers) Act 2007 (see Merger). |
| Treasury segment | The treasury segment's responsibilities usually include capital management, risk management, strategic planning and investor relations. |
| Unaudited | Financial information that has not been subjected to the audit procedures undertaken by the Bank's external auditor. |
| Unfunded pension scheme | Pension scheme which has liabilities and no assets. The Bank will pay the liabilities of the scheme as they fall due. |
| Unsecured lending | Lending for which there is no collateral for the loan. |
| Verde business | Separated part of the Retail business of the Lloyds Banking Group. |
| Value at risk (VaR) | VaR measures the daily maximum potential gain or loss due to market volatility within a statistical confidence level of 95% and a one day holding period. The VaR methodology employed is historical simulation using a time series of one year to latest day. |
| Watchlist | A list of counterparties, drawn up by the Bank once it has elected to closely monitor the performance of loans subject to significant credit risk. |
| Wholesale | Wholesale banking is the provision of loans to corporate customers and institutional customers and services to other banks and financial institutions. |
| Write down | After an advance has been identified as impaired and is subject to an impairment allowance, the stage may be reached whereby it is concluded that there is no realistic prospect of further recovery. Write downs will occur when, and to the extent that, the whole or part of a debt is considered irrecoverable. This action can occur at any time in the debt's life (see Charge off). |

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