The Co-operative Bank plc announces that the following document has today been submitted to the National Storage Mechanism and will shortly be available for inspection at www.morningstar.co.uk/uk/NSM:

• Annual Report and Accounts 2015.

A copy of the Annual Report and Accounts 2015, Pillar III Report 2015 and an investor presentation are available within the Investor Relations section of our website www.co-operativebank.co.uk/investorrelations.

This announcement also contains additional information for the purposes of compliance with the Disclosure and Transparency Rules, including a consolidated set of financial statements, principal risks and uncertainties, details of related party transactions and a responsibility statement. This information is extracted, in full unedited text, from the Annual Report and Accounts 2015. Reference to pages and numbers refer to page numbers and notes to the 2015 Annual Report and Accounts and 2014 comparatives are as restated in those accounts.

The Co-operative Bank plc

1 April 2016

Annual Report and Accounts for the full year ended 31 December 2015

Summary:

- Bank losses before tax widened, as expected, to £610.6m in 2015 (£264.2m in 2014), reflecting the issues of the past. At the same time, a viable Core Bank is emerging as evidenced by the significantly improved Core Bank operating result which narrowed to a loss of £14.9m (£78.6m in 2014).
- Capital resilience of the Bank strengthened – Common Equity Tier 1 (CET1) ratio increased to 15.5% at December 31 2015 (13.0% at December 31 2014) as a result of a reduction in Risk Weighted Assets (RWAs) of £5.2bn and a statutory loss before tax of £610.6m.
- Successful deleveraging of Non-core progressed with customer assets reducing to £4.9bn from £10.3bn at the end of 2014 resulting in a reduction of £4.4bn of credit RWAs and producing a loss on asset sales of £121.4m.
- The Bank executed two successful securitisations of a total of £3.1bn of Non-core residential mortgage assets within the Optimum portfolio which closed in May and September 2015.
- The Bank’s total capital position was improved by the issue of £250m of Tier 2 subordinated debt in July 2015 in challenging market conditions, helping increase the Bank’s 31 December 2015 total capital ratio to 21.6% from 15.0% at the end of 2014.
- Net interest margin increased by 20bps in 2015 to 1.42% (1.22% in 2014). This improvement is due to a combination of deposit repricing and mix change.
- Good progress was made in the cost reduction programme with total operating expenditure reduced to £491.9m for 2015 (£568.4m in 2014).
- Remediation and strategic project expenditure remained high in 2015 at £224.2m (£206.1m in 2014) as the Bank delivers the transformation required to address the historic underinvestment in systems and processes.
- Overall performance of the Core Bank improved during 2015 – the number of mortgage completions more than doubled year-on-year and as a result, the overall Core Bank loan book was stable during the second half of 2015. The number of prime current accounts increased in 2015 and the total number of current accounts remained broadly stable. Customer service excellence was maintained with the Bank’s current account NPS increasing to 24 from 15 with the Bank ranking #3 among its peers up from #4 in the first half of 2014.
- Reinvestment in the brand in 2015 with the launch of a number of new products guided by our revised, customer-led Ethical Policy (January 2015) – overdraft proposition (April 2015), new balance transfer credit card (November 2015), and rewards based current account (January 2016).

- Conduct and legal risk charges increased to £193.7m in 2015 (£101.2m in 2014) due to additional provisions relating to PPI of £71.8m, CCA unenforceable interest of £58.3m and £40.4m relating to the overall cost of CCA redress. No new significant categories of conduct risk were identified. The conduct risk charges predominantly relate to legacy issues that are common across the industry and in the case of PPI are in line with peers.
- Focus for management for 2016 continues to be the turnaround of the Bank, making it more resilient with a view to building a profitable bank focused on retail and SME customers over the longer term.

Strategic update

- The Bank has adjusted its strategic plan in light of market conditions and recent developments including: lower for longer interest rates; prevailing market pricing for Non-core assets; capital market volatility; increased 2015 provisions for conduct risk; and further clarity around future capital requirements and impacts for MREL.
- The key strategic adjustments incorporated into the Updated Plan (2016-2020) relate to the Bank ceasing any further planned deleverage of the Non-core Optimum portfolio and the re-profiling of the Bank’s debt issuance programme. The Updated Plan has been accepted by the PRA.
- With the benefit of the deleverage undertaken in 2015 and the continued increase in employment and HPI, the remaining Optimum portfolio is considered to pose less of a risk than at the time of the 2014 stress testing exercise. In addition, given current market volatility, the Bank also does not believe that it can achieve similar pricing to that of the Warwick 1 and 2 transactions and thus any further deleverage in the near term would be capital destructive without any significant improvement in resilience. The Bank’s strategy has evolved to continue to hold these assets, in order to mitigate any further losses resulting from the sale of the assets and to protect income and therefore CET1 capital in a lower for longer interest rate environment. However, the Bank will reassess this position, considering market conditions over time.
- The Bank's Updated Plan (2016-2020), as accepted by the PRA, incorporates MREL qualifying issuance commencing in 2018 which is the Board's current view of the earliest time when such issuance may be feasible. Both the PRA and the Bank of England have indicated their strong preference that the Bank incorporate an earlier profile of MREL issuance than currently contemplated by the Bank's Updated Plan but both confirmed that these expectations are not intended yet to represent the formal setting of a required MREL issuance plan. However, should the Bank be able to issue MREL earlier than currently considered feasible, then it would do so. In the event of earlier than planned issuance of MREL taking place the impact on the plan would be to possibly delay ICG and PRA buffer compliance and Core Bank operating profitability and the PRA and Bank of England are aware of these possible outcomes.
- Subject to the above and other principal risks and uncertainties in the Annual Report and Accounts, the Bank now expects to comply with its Individual Capital Guidance (ICG) by the end of 2019 and PRA buffer by end of 2020.

Niall Booker, Chief Executive Officer, said:

“In 2015 we have been successful in improving capital resilience, reducing costs and strengthening the performance of the Core Bank and the expected widening of our financial loss compared with 2014, due to legacy issues we have known about and highlighted for some time, should not distract from the considerable progress made in turning the Bank around. The work done in de-risking and simplifying the Bank means the business is much stronger than a year ago and, in particular, the continued strengthening of the performance of our retail franchise is encouraging for the future. Whilst the Bank as a whole will report a loss before tax in 2016 and 2017, we expect a return to operating profitability in the Core Bank before the end of 2017.

Since the Bank of England’s stress tests in December 2014, we have reduced Non-core assets by almost half, raised £250m of Tier 2 capital, and we have met our commitment to the regulator for CET1 ratio and RWAs for 2015. These actions have considerably strengthened the Bank’s capital resilience but the impact of prolonged lower interest rates, increased conduct risk charges and market volatility means that the Bank's plan now incorporates retaining the Optimum portfolio for the life of the plan although we may make earlier disposals, subject to market conditions. Accordingly the Bank now forecasts that it will meet regulatory stressed capital requirements in 2020, although this date could get pushed out further if we meet the profile of MREL issuance preferred by the PRA and BoE which is earlier than our current plan.

As expected, the headline numbers today show the continued impact of legacy issues on our financial performance including losses on asset sales, fair value amortisation, strategic and remediation project expenditure, and the industry wide issue of increased conduct risk provisions. As we have said previously, in the latter part of the plan we expect the impact of historic issues to begin to materially reduce. The introduction of more competitive products; a doubling of mortgage completions year on year; clear stability in current account numbers and improved brand performance and customer relationship scores in 2015 provide good reasons to be optimistic about the future and we will be investing further in transforming the retail business in the year ahead. There is still considerable work required to fully implement the Updated Plan but we remain positive that we are gradually developing a more resilient bank, distinguished in the market by our values and ethics that can create value for all our stakeholders over time."

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About The Co-operative Bank

The Co-operative Bank plc provides a full range of banking products and services to 4 million retail and SME (Small and Medium Sized Enterprises) customers. The Bank is committed to values and ethics in line with the principles of the co-operative movement. The Co-operative Bank is authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority. The Co-operative Bank plc customers are protected by the Financial Services Compensation Scheme (FSCS) in the UK.

Forward looking statements

This document contains certain forward looking statements with respect to the business, strategy and plans of The Co-operative Bank and its current goals and expectations relating to its future financial condition and performance. Statements that are not historical facts, including statements about The Co-operative Bank's or its Directors' and/or management's beliefs and expectations, are forward looking statements. By their nature, forward looking statements involve risk and uncertainty because they relate to events and depend upon circumstances that will or may occur in the future. Factors that could cause actual business, strategy, plans and/or results to differ materially from the plans, objectives, expectations, estimates and intentions expressed in such forward looking statements made by the Bank or on its behalf include, but are not limited to: general economic and business conditions in the UK and internationally including the United Kingdom referendum on membership of the European Union scheduled to take place on 23 June 2016; inflation, deflation, interest rates and policies of the Bank of England, the European Central Bank and other G8 central banks; fluctuations in exchange rates, stock markets and currencies; changes to The Co-operative Bank's credit ratings; changing demographic developments, including mortality and changing customer behaviour, including consumer spending, saving and borrowing habits; changes in customer preferences; changes to borrower or counterparty credit quality; instability in the global financial markets, including Eurozone instability and the impact of any sovereign credit rating downgrade or other sovereign financial issues; technological changes; natural and other disasters, adverse weather and similar contingencies outside The Co-operative Bank's control; inadequate or failed internal or external processes, people and systems; terrorist acts and other acts of war or hostility and responses to those acts; geopolitical, pandemic or other such events; changes in laws, regulations, taxation, accounting standards or practices; regulatory capital or liquidity requirements and similar contingencies outside The Co-operative Bank's control; the policies and actions of governmental or regulatory authorities in the UK, the European Union, the US or elsewhere; the implementation of the EU Bank Recovery and Resolution Directive and banking reform, following the recommendations made by the Independent Commission on Banking; the ability to attract and retain senior management and other employees; the extent of any future impairment charges or write-downs caused by depressed asset valuations, market disruptions and illiquid markets; market relating trends and developments; exposure to regulatory scrutiny, legal proceedings, regulatory investigations or complaints; changes in competition and pricing environments; the inability to hedge certain risks economically; the adequacy of loss reserves; the actions of competitors, including non-bank financial services and lending companies; and the success of The Co-operative Bank in managing the risks of the foregoing.

The ability of the Bank to implement its Updated Plan and to achieve the results set out in the plan requires the regulators' continued acceptance of the plan and entails particular challenges including (but not limited to): ability to execute a substantial re-engineering of the Bank's operating model and a very large and complex IT remediation programme; ability to achieve targeted cost savings; ability to retain customers and deposits; the timing and quantum of impacts to capital from the Bank's asset reduction exercise; meeting its planned improvements in net interest margin; a possible deterioration in the quality of the Bank's asset portfolio; unplanned costs from (for example) conduct risk matters; ability to maintain the Bank's access at an appropriate cost to liquidity and funding and the ability of the Bank to raise further capital assumed in its Updated Plan. Additional risks and uncertainties are included in this announcement. Any forward-looking statements made in this document speak only as of the date they are made and it should not be assumed that they have been revised or updated in the light of new information of future events. Except as required by the Prudential Regulation Authority, the Financial Conduct Authority, the London Stock Exchange plc or applicable law, The Co-operative Bank expressly disclaims any obligation or undertaking to release publicly any updates of revisions to any forward-looking statements contained in this document to reflect any change in The Co-operative Bank's expectations with regard thereto or any change in events, conditions or circumstances on which any such statement is based.

Bank performance

Key highlights and outlook

In 2015 further significant steps were taken to implement the Bank's turnaround

- Successfully completed three transactions which improved the capital resilience of the Bank. In 2015 we completed two whole structure securitisations representing £3.1bn of the Non-core Optimum residential mortgage portfolio and a £250m Tier 2 notes offering.
- Capital position of the Bank strengthened – Common Equity Tier 1 (CET1) ratio of 15.5% at 31 December 2015 (13.0% at 31 December 2014) as the reduction in capital supporting RWAs outweighed losses during the period.
- As a result of active management the net interest margin has increased year on year by 0.20% to 1.42% largely driven by the reduced cost of funding.
- Continued brand investment, following the launch of the expanded Ethical Policy announced in January 2015, is building greater customer engagement, current account stability and restoring trust in the brand.
- Progress continues in improving day to day management, and embedding cultural change across the organisation.
- Progress has been made in delivering the IT transformation required to address the historic under

investment in systems and processes. Work continued on the cornerstone IBM Enterprise Services Outsourcing (ESO) programme.
- The mortgage outsourcing agreement came into effect in August 2015.

Statutory loss before taxation of £610.6m as the issues that came to light during 2013 and 2014 continue to dominate the financial performance of the business

- Compares to a loss of £264.2m in 2014 driven primarily by: reduction in net interest income in the Non-core Bank of £37.7m as a result of deleverage; reduction in non-interest income of £45.2m; losses on asset sales of £121.4m; and reduced impairment gains in Non-core.
- In addition, conduct and legal risk charges increased by £92.5m to £193.7m due to additional provisions relating to Payment Protection Insurance (PPI) and Consumer Credit Act (CCA).
- Remediation and strategic project costs remained high in 2015 at £224.2m (2014: £206.1m) as the Bank delivers the transformation required to address the historic under investment in systems and processes.
- Fair value amortisation associated with the merger with the Britannia Building Society increased in 2015 to £120.4m (2014: £83.9m).

Simplifying of the business and reducing underlying costs continues

- Total operating costs reduced by £76.5m to £491.9m (2014: £568.4m (current basis), refer to page 21 for details), mainly due to head-count reduction, branch closures, rationalisation of the ATM network and improved management and control of third party costs.
- Operating staff costs have decreased year on year by £32.8m to £217.8m (2014: £250.6m). Permanent FTEs has fallen by 1,012 to 4,470 (2014: 5,482) and direct pay has fallen by £19.6m.
- 58 branch closures conducted in 2015.
- 54 further branches are to be closed in 2016 as a result of the observed 29% year on year reduction in branch transactions.

Rebuild of the Core Bank franchise is gaining traction

- Improved Core Bank operating result of £14.9m loss in 2015 (2014: £78.6m loss), as higher net interest income and reduced costs offset the lower level of non-interest income.
- Mortgage completions increased to £2.8bn in 2015 (2014: £1.1bn), 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 to £2.3bn (2014: £2.4bn).
- Rebalancing the savings portfolio as Non-core deleveraged and bringing pricing of deposits in line with the market has enabled the Bank to develop a more sustainable cost of funding. Retail customer liabilities reduced by £5.8bn to £19.7bn as a result.
- Prime current account holders have increased in 2015 to 655,965 (2014: 651,214), as work continues to re-establish the Bank's position in a very competitive market. Total current account numbers saw a marginal decrease.
- Customer relationship metrics across the Bank remain strong with the Bank still ranked #3 in current account Net Promoter Scores (NPS) and customer satisfaction ratings. Encouragingly, non-customer consideration scores have also increased, further indicating the strengthening of the brand.
- The Bank was YouGov brand index most improved UK brand of 2015.

New initiatives launched and customer propositions being developed, building on the expanded Ethical Policy

- Expanded customer-led Ethical Policy launched in January 2015.

- New overdraft proposition minimising fees and charges, based on customers' feedback, launched in April 2015.
- Further to the fixed rate credit card introduced in November 2014, a new balance transfer credit card introduced in November 2015, which does not penalise the cardholder by withdrawing their zero percent offer for small mistakes on their account.
- New rewards based current account proposition launched in January 2016.

Focus for 2016 continues to be on derisking the Bank and rebuilding the Core Bank

- Continue reduction of RWAs primarily through further Corporate CoAM deleverage.
- Deliver the necessary IT resilience and transformation projects across the Bank, including ESO and continue work on the mortgage processing outsourcing project.
- Continue investment in the brand and development of products and services which reflect the customer-led Ethical Policy.
- Further improvement in processes, cost control and asset generation in the Retail business.
- Continue to embed the Risk Management Framework and strengthen the culture of the Bank.
- Continue improvement in quality of service.

Chairman's statement

In 2015, The Co-operative Bank made further significant progress in the turnaround of the Bank from the low point of the recapitalisations in late 2013 and early 2014. Following these events, we embarked on a five year plan to materially de-risk the Bank and to rebuild a viable, profitable, customer focussed Core Bank, distinguished by values and ethics, serving personal and small and medium sized business customers in the UK. To date, we have made real progress in meeting most of those demanding targets, although we continue to feel the impact of macroeconomic headwinds and some of the legacy conduct issues which, in common with the rest of the industry, are taking longer to work through than originally anticipated.

When looking at the key elements of our five year plan, the first task was to improve capital resilience and capital has been further strengthened with a CET1 ratio of 15.5% at the end of 2015, compared with 13.0% at the end of 2014. During the year we also raised £250m of Tier 2 capital in volatile market conditions. The disposal of over half of the Optimum portfolio of Non-core residential mortgages, at robust pricing levels, means we have exceeded the 2015 targets agreed with the regulator for CET1 ratio and RWAs which improves our resilience to a severe economic stress.

Our continued success in disposing of Non-core customer assets, from £11.5bn in June 2014 to £4.9bn at end of 2015, has contributed to a significant reduction in total RWAs, which are now almost half the level seen in 2013. Encouragingly, impairment provisions put in place in 2013 have proved to be robust, although the level of impairment gains is unsurprisingly lower in 2015 than 2014. Continued low interest rates and lower defaults are also having a positive impact on the level of new credit impairments.

Our liquidity has been proactively managed and improved as we have successfully deleveraged Non-core assets and the improved strength of the franchise has meant we are less reliant on highly priced retail deposits. As a result, primary liquidity has been managed down to £4.5bn at the end of 2015 which is materially less than the £7.6bn held at the end of June 2014.

The Core Bank has delivered change and improvements around brand, products, distribution channels, customer focus and service excellence. Having relaunched our expanded ethical policy at the beginning of 2015, we continue to place values and ethics at the heart of the business. We have introduced a number of new products driven by our ethical policy, developed with our customers, and we have seen our net promoter score rise during the course of the year. Although there has been a slight reduction in income, the net interest margin continues to widen and costs continue to fall such that the Core Bank's operating result has improved and is much closer to break-even. This creates a strong base on which to build further.

Underlying this, good progress has been achieved in addressing previous under-investment in IT and Operations in order to transform our capabilities. Key milestones were successfully met in 2015, in particular relating to the outsourcing of our IT infrastructure and mortgage servicing although further major deliveries lie ahead in 2016. We continue to build colleague capability to ensure that we deliver consistently on our customer promises and we have seen clear evidence of improving colleague engagement.

However, legacy conduct issues are not yet fully resolved. Some of these are driven by industry-wide issues, particularly in respect of PPI. Others such as our CCA redress programme are impacted by the need for robust data to enable us to meet our obligations. The additional costs arising from these are significant and have had a clear impact on our full year statutory loss. They continue to receive close Board and Executive attention.

During the year, the investigations by the Financial Conduct Authority (FCA) and Prudential Regulation Authority (PRA) into what went wrong at the Bank in the period up to 2013 were concluded. The Board has taken the findings and the size of the potential fine extremely seriously and, 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.

Our restructuring and renewal of the Board has progressed substantially. We continued to strengthen the Board during 2015 with the appointments of Charles Bralver as a Non-Executive Director and Aidan Birkett as our new Senior Independent Director. In addition, Derek Weir has now been appointed as the new Chairman of the Risk Committee and I would like to place on record my sincere thanks to the outgoing Chairman, Graeme Hardie, for the significant contribution he has made to the Board, first helping to navigate the Bank through its recapitalisation and secondly in overseeing the early years of the turnaround of the Bank. Graeme will step down from the Board with our best wishes at the AGM. Your Board is committed to continuous improvement in oversight and governance and we have recently completed an externally assessed Board Effectiveness review which both endorses the progress made since Sir Christopher Kelly's 2014 report and makes recommendations for further development.

Outlook

We remain optimistic about the viability of the Core Bank franchise. The next two years will see further significant investment in the transformation of the Bank and the unwinding of further fair value adjustments so the Bank as a whole will report a loss before tax in 2016 and 2017. However, we expect both the level of investment and the impact of historic issues to materially reduce in subsequent years and it is becoming evident that there is a viable Core Bank with a solid franchise emerging which we expect to return to operating profitability before the end of 2017.

In addition, having significantly reduced the size of the Optimum portfolio and reflecting market conditions which would drive a significant loss on sale, the Board has recently reassessed the quality and income generated from the remaining portfolio and has decided to retain it for the life of the Bank's Updated Plan, which runs from 2016 to 2020, a position which has been accepted by the PRA. We will continue to reassess the position going forward in line with emerging market conditions.

However despite our success to date, the impact of legacy conduct charges on our 2015 statutory loss, as well as the headwinds created by forecasted lower interest rates, means that the journey to the level of capital resilience expected by the regulator will take one year longer than previously anticipated, with sustainable ICG compliance achieved in 2019 and PRA Buffer compliance achieved in 2020.

The transformation required to rebuild The Co-operative Bank as a viable alternative to other UK banks is not an easy task. On behalf of the Board I would like to thank our colleagues for the excellent service they provide to our customers, to our customers for their continued loyalty and to our 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
31 March 2016

Chief Executive's review

Over the course of 2015, we have continued to make real progress in implementing our plan to turnaround the Bank. Our work to improve resilience, reduce cost and strengthen the performance of the Core Bank continues to deliver positive results notwithstanding the headline numbers and we remain cautiously optimistic this will continue into 2016 and beyond. I would like to thank colleagues for their hard work and determination as we continue to tackle and address the problems of the past and create a sustainable business around our personal and SME business customers.

Whilst the headline losses are significant, they were driven by legacy issues including fair value unwind, losses on the disposal of Non-core assets, transformation project spend and conduct charges. With the exception of the latter, these were all anticipated at the beginning of the year and the increase in conduct charges has to some extent been driven by factors impacting all banks, in particular PPI. They do not reflect the considerable progress in the Bank, on which I will elaborate below, and importantly have no major impact on the Core Bank which produced a close to break even result.

Since the Bank of England stress tests in December 2014, we have taken steps to significantly improve resilience in the event of a severe economic downturn. The reduction of more than half of our Non-core assets since the end of 2014, including two whole structure securitisations of £3.1bn of the Optimum residential mortgages portfolio, alongside the issuance of £250m of Tier 2 notes, means we have met our CET1 ratio and RWA commitments to the Regulator in 2015.

The performance of the Core Bank continues to improve. We have seen clear stability in our current account numbers with the overall number of prime current accounts increasing by 4,751 in 2015. Strong customer relationship metrics across the Bank reflect the excellent levels of service being delivered in our branches and contact centres and we have continued to invest in the brand which has been recognised as the most improved by YouGov in 2015. The level of mortgage completions more than doubled year on year, representing the highest value of new lending delivered by the Bank since 2010. In addition, the total Bank net interest margin improved by 20bps throughout 2015. Reassuringly, colleague engagement also increased by 16 percentage points giving some indication that our cultural change programme is gaining traction.

We continue to make good progress on cost reduction and as we enter 2016, the outsourcing of our IT infrastructure to IBM is on track.

The Bank remains exposed to external macroeconomic conditions and some of the legacy issues from the past. Although we have made steady progress in tackling remediation, we continue to be exposed to the impact of historic conduct issues such as CCA and PPI and we have increased our provisions which has impacted our statutory loss in 2015. In the case of CCA, this remains very difficult and detailed work. On PPI, in line with the rest of the industry, we have seen complaints from claims management companies continue at higher levels than previously anticipated. We now expect to receive complaints until at least 2018 when the proposed time bar may come into effect.

In today's challenging market conditions, further disposals of the Optimum portfolio would create a significant loss on sale. We have therefore adapted our plan (the Updated Plan 2016-2020) and now envisage keeping the remainder of Optimum for the life of our plan and we have agreed this with the PRA. This will protect income generation without unduly impacting the risk profile of the Bank as the average Loan to Value of the portfolio has improved significantly over the last two years and we have significantly reduced the size of the portfolio through the whole structure securitisations undertaken in 2015. We will continue to reassess this position going forward in line with market conditions as there may be opportunities to take advantage of acceptable pricing to make earlier disposals.

The Bank continues to face a number of headwinds including the expectation that interest rates are forecast to remain lower for longer. The impact of this which leads to slower revenue generation and the loss incurred in 2015, means that we now expect to reach sustainable compliance with our Individual Capital Guidance (ICG) by 2019 and the Regulator's PRA buffer by 2020 and the PRA has accepted this.

None of this should diminish the progress we have made in the turnaround of the Bank without the need for financial support at the expense of the taxpayer. We remain positive that we are developing a more resilient bank, underpinned and differentiated by values and ethics, and that a profitable Core Bank will emerge from the turnaround creating further value for all our stakeholders.

Performance Review

The Bank has made significant progress against its Revised Plan, perhaps most notably through the two whole structure securitisations of the Optimum residential mortgages portfolio (Warwick Finance One and Warwick Finance Two). With the successful completion of the second transaction in September, the Bank securitised almost half of the Optimum portfolio (£3.1bn) within six months. The significant reduction in RWAs from the deleverage of Optimum and other parts of the Non-core business has contributed to the improvement of the Bank's CET1 ratio, which now stands at 15.5% up 2.5% from 13.0% at the end of 2014. The Bank has also benefited from the proposed sale of Visa Europe and has recognised a £51.2m gross revaluation gain in relation to this transaction which has resulted in an increase in the Bank's available for sale reserve and has also increased CET1 capital by the same amount.

The Bank's overall net interest margin increased by 20bps from 1.22% in 2014 to 1.42% in 2015. This was largely driven by a reduction in the underlying costs of deposits and lower funding requirements as a result of the Non-core deleverage during the year. Although the Non-core deleverage reduced asset balances so that total Bank net interest income declined year on year, there was an improvement in Core Bank net interest income of £15.8m, totalling £460.6m for 2015. However, Core Bank non-interest income has reduced significantly year on year by £38.0m, to £52.4m in 2015. This was primarily due to lower Link commission fees following the disposal of the majority of the ATM estate, as well as a market wide reduction in card interchange rates and reduced overdraft fees on the back of improvements we made for customers on our overdraft product.

Operational costs reduced from £568.4m to £491.9m, driven mainly by rationalisation of the branch network, reduction in the ATM estate, reduction in the number of permanent employees and reduced reliance on contractors.

As we have said before, legacy issues continue to impact the financial position of the business and there are still significant challenges ahead. The statutory loss before taxation widened from a £264.2m loss in 2014 to £610.6m in 2015, most of which was anticipated with the exception of increased conduct risk charges. The main drivers were: our deleverage strategy leading to higher losses on asset sales of £121.4m in 2015 against £14.4m in 2014; increased conduct and legal risk charges of £193.7m against £101.2m in 2014; fair value accounting unwinds of Leek notes, which created a loss of £120.4m in 2015 compared to £83.9m in 2014 and increased remediation and strategic project costs needed to deliver the transformation required at £224.2m in 2015 against £206.1m in 2014.

The conduct risk charge primarily relates to CCA, PPI and packaged accounts. There was a £98.7m charge caused partly by slower than expected progress in the remediation of the previously identified breaches of the technical provisions of the CCA and partly by the discovery of new cohorts of customers requiring remediation. Although the new cohorts were identified as a result of more advanced data scrutiny, importantly, no major new failings were uncovered. The monthly amount of interest forgone has reduced significantly during the year. The increase in the existing provisions for PPI by £71.8m was due to a sustained higher level of inbound PPI complaints than previously anticipated. We now expect a higher level of complaints to continue with the announcement by the FCA that a time bar and associated marketing is likely to be applied to PPI complaints. The charge also comprises a £16.8m increase in provision required for historic mis-selling of packaged accounts due to an increase in the number of inbound complaints. However, it is important to note that these increased charges all relate to legacy issues with no new significant categories of conduct risk having been identified in 2015.

Increased capital and IT resilience

As agreed with the PRA in December 2014, the focus for 2015 was to de-risk the Bank and increase its capital resilience. Central to this was the active reduction of RWAs, with a focus on the Optimum residential mortgage portfolio. This portfolio was particularly susceptible to stress in the Bank of England's 2014 stress test scenario. The Non-core and Treasury team, in conjunction with other colleagues across the Bank, have deployed their considerable experience and skill to manage the deleveraging activity effectively, securitising £3.1bn of the Optimum portfolio, which, coupled with a natural portfolio run-off, resulted in the overall reduction of Optimum assets from £6.8bn in 2014 to £3.2bn in 2015. This reduction has substantially de-risked the impact of these assets on capital in a severe economic stress scenario. The recent economic environment has led to an improvement in the underlying credit quality of the assets due to a significant reduction in the portfolio's Loan to Value and a reduction in the proportion of the book in arrears.

Given the reduction in risk which has already taken place, current market conditions and the loss on sale that would be created, we do not believe that further disposals of Optimum, which would also reduce income and erode capital, are appropriate. We therefore now expect to hold the remainder of the Optimum portfolio for the life of the Updated Plan although we will continue to reassess this position in line with market conditions and pricing.

Continued asset sales within CoAM contributed heavily to a reduction of other Non-core assets from £3.9bn to £2.0bn. This has led to an overall reduction of Non-core RWAs from £7.2bn in 2014 to £2.8bn in 2015 which is better than expected. Nonetheless, we still have work to do to ensure sustainable compliance with our ICG by 2019 and PRA buffer by 2020. While there are currently no regulatory mandatory requirements for MREL issuance, the PRA and Bank of England have expressed a strong preference for earlier issuance of MREL than the later part of our Plan which is the Board's current view of the earliest time such issuance is feasible. To the extent that the Bank can achieve an earlier issuance, it will do so but this could further delay ICG and PRA buffer compliance and possibly the return to operating profitability of the Core Bank. The PRA and Bank of England are aware of these potential consequences and that further delay of compliance would need to be accepted. Whilst the Bank of England will have powers to mandate capital MREL compliance when the regulations regarding MREL are put in place, it has stated that it will consult with the Bank before setting binding requirements to mandate MREL issuance.

The work to separate our IT infrastructure from The Co-operative Group and migrate it to IBM (Enterprise Services Outsourcing), which will improve the resilience of our IT platform, is progressing with significant deliverables due in 2016. The build out of the primary and back-up data centres is complete. Bank data and applications have been copied onto the new technical infrastructure and an extensive programme of testing has commenced. Migration of the Bank's critical systems is progressing in 2016.

Finally, we have continued the work to improve the Risk Management Framework. Refreshed risk appetite statements and measures have been agreed as part of the Bank's plan and adherence to the framework is being formally monitored; we still have further work to do to embed this to our own and the Regulators' satisfaction. We have also made progress in implementing the Senior Managers Regime, which came into effect in March 2016, and we are currently ensuring this is embedded effectively.

Liquidity

Liquidity continues to reduce from the levels seen in 2013 and 2014 and primary liquidity has reduced by £2.0bn during 2015 to £4.5bn at December 2015. The main changes in the liquidity position are due to the rebalancing of the savings portfolio by repricing certain retail deposits in line with the market, resulting in a more sustainable cost of funding and improved net interest margins. The liquidity reduction driven by savings rebalancing also reflected the reduced funding requirements following the deleverage of Non-core assets. In addition, following regulatory guidance in 2015, both the Regulator and the Bank are comfortable in relaxing the Bank's required liquidity levels in stressed situations, and the Bank's Liquidity Risk Appetite has been updated accordingly. Nevertheless, as we remain predominantly retail deposit funded, our appetite is to hold comparatively higher overall levels of liquidity.

Core Bank

The Core Bank continued to make steady progress throughout 2015, with the focus placed firmly on investing in our products, the brand and our service. We are engaging with customers who, like us, believe values and ethics have an important role to play in banking. Our current account Net Promoter Score (NPS) increased from 15 to 24 and we were recognised as the most improved brand of the year by YouGov.

Alongside the excellent work of our customer facing colleagues, we have continued our efforts to strengthen our customers' trust in us by investing in our brand. Our television adverts and the focus on our donation on behalf of our customers to one of seven charities enabled us to reinforce our status as the ethical alternative to other high street banks. Encouragingly, both NPS and non-customer consideration scores have increased year on year, further indicating the returning strength of the brand.

Mortgage originations continued to improve throughout the year, with total completions for 2015 above expectation at £2.8bn compared with £1.1bn in 2014. This is the highest level of new mortgage lending since 2010. In addition, we have started to see early signs of a reduction in mortgage redemptions with redemptions falling from £2.4bn in 2014 to £2.3bn in 2015. The reinvigoration of our mortgage pipeline through our intermediary business played an important part in this success and we were pleased to see our Platform business was awarded the Intermediary Mortgage Lender of The Year by Your Mortgage. It is important to note that whilst the Core lending book remains broadly stable, we remain cautious and acknowledge that there is increased pressure on margins due to strong competition in the mortgage market which will continue in 2016 and possibly beyond. The outsourcing of our mortgage processing to Capita (which came into effect in August 2015) is progressing and will, over time, improve the Bank's ability to process mortgage applications, help to improve retention and reduce costs.

2015 represented a year of stability for our overall current account base. We have seen an increase in current account credit balances of £0.3bn to £3.8bn and Prime current accounts have increased by 4,751. Whilst the total current account base decreased in 2015, the net outflow was only 799 and showed a marked improvement from the net outflow of 66,340 in 2014. The launch in January 2016 of our Everyday Rewards current account means we now have a competitive current account proposition, which has generated a positive response from the media.

Following the introduction of a three year fixed rate credit card in November 2014, which was positively received by customers, we have also applied the principles of simplicity, transparency and fairness to our balance transfer card which was launched in November 2015. The card not only offers zero percent interest on balance transfers for 24 months, but does not penalise customers for late or missed payments by the withdrawal of the zero percent offer unlike many other lenders. This is an example of developing our products in a way which reflects our values and ethics.

In line with the commitments of our expanded Ethical Policy, we have taken steps to involve customers and incorporate their views in developing other products. Our revised overdraft policy, launched in April 2015, was the first of our products to be created together with customers. The consumer group Which? were also engaged throughout the proposition development and have provided positive feedback around the Bank's approach of listening to customers and making products that work for them. The Bank also received praise for making a 'positive move' towards transparency, living up to its values and ethics and delivering a much fairer overdraft tariff. Perhaps the most significant indication of the increased transparency was a 77% reduction in complaints related to overdrafts comparing the three months before and after the changes were made. We are proud to be at the forefront of a market offering products that are simpler for consumers to understand.

We are also committed to making banking as easy as possible for our customers. Throughout 2015, we have continued to make improvements to our digital channels, reflecting customers' changing preferences for how they do their day-to-day banking. These improvements have resulted in a 22% increase in online banking payments and a 110% increase in mobile banking payments. More and more customers are opting to use our digital services with around 749,000 customers regularly using our improved online and mobile banking services. 55% of these customers receive paperless statements only. Further digital improvements are planned in 2016.

It is particularly pleasing to note that the Bank received a number of awards for customer service in 2015, which is welcome recognition of the excellent service being delivered by colleagues in our contact centres and branches. Most notably, our call centre service was recognised as the Best Large Call Centre and the Most Improved Call Centre for customer service by ICMI. Our current account was awarded a 5 star rating by Moneyfacts and we remain one of the top 3 banks for customer satisfaction and current account NPS.

Over time it seems customers increasingly want frictionless transaction services from the Bank. These are best delivered digitally and using straight through processing. This has benefits for both the Bank and the customer. In almost direct contradiction to this, however, when something goes wrong, customers want a real person to talk to. We have made significant strides in dealing with complaints with the overall level of complaints falling by 19%. Based on industry data provided by GfK FRS, we are one of the leading banks for resolving complaints to customers' satisfaction.

Finally, the Bank is in the process of reclassifying some performing Non-core assets into the Core Bank as these are less risky than previously thought or, due to cheaper funding, now deliver acceptable returns on capital.

Cost reduction

Our efforts to reshape the Bank into a smaller, simpler organisation have maintained the focus on reducing the underlying costs of the Bank and we have delivered positive results in this regard. Operations and central costs have been reduced by £43.7m (from £355.6m in 2014 to £311.9m in 2015) which includes the progress we have made in selective outsourcing and improving our own processes. Operating staff costs have decreased year on year by £32.8m to £217.8m with a corresponding reduction of 1,264 permanent and contractor FTE which includes staff transferred as part of outsourcing. At times, this means we have had to make difficult people-related decisions but this is critical to delivering a cost base which supports a sustainable Core Bank.

We continue to provide branches where we know they are well used whilst at the same time adjusting our estate to reflect customers' changing preferences for how they do their day-to-day banking. Accordingly, there were 58 branch closures in 2015 and although we are now nearing the end of our plan for significant branch closures, we will continue to optimise the location of our branches in line with our customers' changing requirements (where we have seen a 29% year on year reduction in branch transactions) and we therefore announced the closure of 54 additional branches in January 2016.

Values and Ethics

Allied to the brand work and in an effort to sustain our differentiation from others in the marketplace, in 2015 we took some key steps towards demonstrating our values and ethics in action. We are proud to be the only high street bank with a customer-led Ethical Policy and in January 2015, we relaunched our expanded Ethical Policy which was well received by customers, colleagues and stakeholders. We kept all of the existing policy commitments and expanded the policy in new areas voted for by customers. In October 2015 we announced a £1m investment and partnership with Co-operatives UK to support the development of the UK Co-operative and social enterprise sector. This will see us providing tools and resources over the next three years to help new and existing Co-operatives grow. It was also heartening to see the Bank returning to its campaigning heritage by working with Refuge to reveal the scale of financial abuse in the UK where, unfortunately, a particularly high number of victims are women. Since the launch, we have been working with the British Bankers' Association and Citizens Advice Bureau to drive real, valuable change for those who experience this type of abuse.

Culture and People

We are now seeing clear signs of cultural change within the organisation. Continued focus on the rollout of revised workplace values has led to increased emphasis on delivering at pace, implementing effectively and taking accountability. This is particularly evident in the improvements made in complaint management for example. In addition, we were pleased to see a marked increase in overall colleague engagement since November 2014, with measures increasing across the board. Finally, recognising that many of the Executive team came on Board to deal with the crisis the Bank faced in 2013, we have started work on succession planning which is critical to the future health of the business and reflective of the increasing emphasis on the Core Bank and BAU processes. This should ensure we are recruiting talented executives with the skillset to take the Core business forward in the coming years.

Outlook

In 2015, we have continued to take some important steps to build resilience and rebuild the Core Bank. Whilst there is still much work to do, we are heading in the right direction and are on track to build a differentiated, resilient bank with an appropriate cost base.

There are still some headwinds in the Updated Plan: a lower for longer base rate environment, the scale of the transformation required and continuing conduct risk provisions are all considerable challenges facing the Bank. In addition, the PRA and Bank of England's strong preference to raise MREL earlier than we believe is feasible will also present challenges in today's market. Nonetheless, the performance of the Core Bank is improving and we are focused on providing simple, transparent products and superior service levels in our contact centres and branches and to support customers who increasingly want to use our digital channels. Whilst the Bank will report a loss before tax in 2016 and 2017, we now expect the Core Bank to return to operating profitability before the end of 2017.

In 2016, we will continue to invest in the brand, improve our digital offering and engage with customers to provide products that reflect our values and ethics and that best meet their future needs. The focus will largely remain on rebuilding the Core Bank, reducing our Non-core business, building capital and operational resilience and in particular migrating our IT infrastructure to IBM.

Delivering these fundamentals will maximise the value we can create for customers, shareholders, colleagues and the communities we serve. It will also bring the Bank in line with regulatory requirements and reduce any potential burden on the taxpayer. Whilst the Bank is a Going Concern and stronger than it was, there remain material issues to address in terms of improving resilience and bringing aspects of our business back within our risk appetite. We also continue to rely on the ongoing support of our regulators as we implement the Updated Plan which will deliver regulatory compliance. Although there is still considerable work to do to tackle the headwinds, the actions we have taken to strengthen the Bank in 2015 represent good progress and continue to align with the strategic alternatives that exist. I am grateful for the support of colleagues, customers and shareholders as we continue to execute against our Updated Plan to reshape our business around our personal and SME business customers.

Niall Booker
Chief Executive Officer
31 March 2016

Detailed financial review

Capital

During 2015, the Bank has continued to deliver against the key objectives of its Revised Plan. The Bank has securitised £3.1bn of Non-core residential mortgages within the Optimum portfolio, and reduced its exposures within Corporate CoAM following rebanking of certain clients, proactive asset sales and non-performing asset workouts. These activities have resulted in a £4.4bn reduction in Non-core RWAs. The deleverage activity carried out has also significantly improved the Bank's stress resiliency, which was a key objective of the Bank's Revised Plan accepted by the PRA, as the assets that have been deleveraged are those that are most risk intensive in a stress scenario.

On 2 November 2015, Visa Inc. announced the proposed acquisition of Visa Europe Limited (VE) to create a single global payment business under the Visa brand. The Bank is a member and shareholder of VE. The Bank's share of the sale proceeds will comprise a mix of: cash, Class A equivalent preferred stock (the preferred stock) and contingent earn-out consideration (the earn-out). The preferred stock will be convertible into Class A common stock in Visa Inc. or its equivalent upon the occurrence of certain events. The preferred stock will be reduced (by making a downward adjustment to the conversion rate) by an amount equal to any covered losses arising from certain litigation, relating primarily to the setting of interchange fees within VE's territory. It is not possible to estimate the value of the earnout with certainty at this time. No amounts will be payable to the Bank until completion takes place. Completion is subject to regulatory approvals and is not expected to occur before 1 April 2016. The Bank has recognised a £51.2m equity investment in its 2015 accounts in relation to this transaction, which has resulted in an increase in the Bank's available for sale reserve and has increased CET1 capital. This is considered a non-significant investment and is risk weighted at 100% within capital requirements.

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

Overall RWAs have decreased by £5.2bn since last year end. Non-core assets have reduced in line with strategy and this is reflected in the £4.4bn reduction in Non-core RWAs. The securitisation of £3.1bn residential mortgages coupled with the natural run-off of the book (£1.8bn) and a reduction in the Optimum temporary adjustment (£0.7bn) has resulted in a £2.5bn reduction in RWAs. A further £1.8bn RWA reduction has been seen in Corporate CoAM, driven by on-going asset sales and deleveraging activity.

Operational RWAs have decreased by £0.2bn following the annual recalculation of the Pillar 1 operational risk requirement subsequent to the 2014 year end results.

The Bank is seeking to enhance its credit modelling capability in a number of key portfolios and is in discussion with the PRA with regards to the approval and implementation of these enhancements during 2016.

A major element of these enhancements relates to how the Bank determines Loss Given Default (LGD) for retail secured mortgages.

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

Following the significant deleverage of the Optimum balances within 2015, the Bank has judged it appropriate to reduce the temporary adjustment from £1.0bn to £0.3bn, in order to ensure that the Optimum risk weighted assets are more reflective of the underlying credit quality of the portfolio. The PRA has not objected to this change.

When the new LGD model is fully implemented, the remaining £0.3bn of the temporary adjustment is expected to be removed in full with the new model directly calculating the appropriate LGD and corresponding RWAs for all the Bank's secured portfolios.

The Bank's CET1 resources have decreased by £0.4bn to £1.2bn, primarily as a result of the £622.8m statutory loss for the year.

The movements outlined above are the primary factors resulting in the Bank's CRD IV CET1 ratio increasing by 2.5% from 13.0% to 15.5%.

CRD IV capital position

	As at 31 December 2015	As at 31 December 2014	Change
Capital ratio			
CET1 ratio	**15.5%**	13.0%	2.5%
Total capital	**21.6%**	15.0%	6.6%
RWAs (£bn)	**7.4**	12.6	(5.2)
Leverage ratio	**3.8%**	4.2%	(0.4%)

The Bank's leverage ratio is 3.8%, down 0.4% from 2014; the on-going balance sheet deleveraging activity has been more than offset by the reduction in Tier 1 capital generated by the statutory loss in the period.

MREL & Tier 2 capital issuance

The banking industry is required to meet a minimum requirement for each of their own funds and eligible liabilities (MREL) to enable national resolution authorities (the Bank of England within the UK) to resolve firms in the event of a firm failing, as part of the European Recovery and Resolution Directive. MREL requirements can be met through holding regulatory capital or MREL compliant debt. The Bank is mindful of the capital implications of the Bank of England's minimum requirement for own funds and eligible liabilities (MREL) regime and the increased debt issuance this will drive, for the banking industry in general but also for the Bank.

The Bank's Updated Plan (2016-2020) incorporates MREL qualifying issuance commencing in 2018 which is the Board's current view of the earliest time when such issuance may be feasible. The PRA and the Bank of England have indicated their strong preference that the Bank incorporates an earlier profile of MREL issuance than currently contemplated by the Bank's Updated Plan. Such expectations have been confirmed by the regulators as not intended yet to represent the formal setting of a required MREL issuance plan and the Bank of England has stated that it will consult with the Bank before setting binding requirements, which it will be able to do at any point following publication of its MREL policy (expected to be sometime in 2016).

The Bank issued £250m of MREL eligible Tier 2 capital notes, in 2015, increasing the level of bail-in-able capital and further improving the Bank's capital resiliency.

This, along with the £5.2bn reduction in RWAs, has resulted in a 6.6% increase in the total capital ratio.

ICG compliance

As at 31 December 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 (CRR). However, due to the Bank's on-going losses, it is not forecast to remain compliant with ICG requirements for most of the planning period.
The PRA has engaged with the Bank throughout 2015 regarding its overall compliance with CRR and its Credit risk modelling capability. Subsequently, the PRA has set the Bank an additional CRR related Pillar 2a capital requirement in the form of a fixed add on in order to cover potential risk in this area. This Pillar 2a capital requirement was not included within the Bank's ICG requirements at 31 December 2015, however, it will be included within the requirements going forward. It is the Bank's intention, subject to model output, to have the add on removed by the end of 2017 at the latest.

As at 31 December 2015, the Bank's Pillar 2a requirement was set at 9.7% of RWAs or £723m, of which 5.5% must be met by CET1.

The Bank's Updated Plan anticipates that the Bank will meet a 7% CET1 ratio throughout the planning period and will have sustainably met ICG by 2019.

The Bank's Updated Plan aims to build a sustainable Core Bank, and is designed to create a surplus to the PRA buffer by 2020.

The Bank anticipates that its leverage ratio will be sustainably above 3.0% by the end of the Plan however it is expected to reduce in the intervening period.

Detailed financial review

Liquidity

Overview

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

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

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

Credit rating

On 31 July 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. Fitch confirmed the Bank's ratings at B in November 2015, but revised the outlook to stable from negative. 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:

- 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;
- a negative impact on the Bank's ability to access short term unsecured wholesale funding; and
- heightened collateral requirements within some clearing systems.

Liquidity portfolio

The Bank's liquidity resources, as at 31 December 2015, were £11.4bn compared to £12.1bn as at 31 December 2014. As at 31 December 2015 the liquid asset ratio was 15.6% (2014: 17.4%). 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 EBA regulations (HQLA) and secondary liquidity consists of all other liquid assets (including self-issued retained securitisations and whole loans).

Primary liquidity has decreased over the period by £2.0bn and secondary liquidity has increased by £1.3bn.

	2015 £m	2014 £m	Change £m
Operational balances with central banks	**2,329.3**	4,487.4	(2,158.1)
Gilts	**1,450.2**	1,246.7	203.5
Central government and multilateral development bank bonds	**760.2**	819.5	(59.3)
Total primary liquidity	**4,539.7**	6,553.6	(2,013.9)
Total secondary liquidity	**6,863.1**	5,566.8	1,296.3
Total liquidity	**11,402.8**	12,120.4	(717.6)

Retail and Commercial funding

The majority of the Bank's funding comes from Retail and Commercial accounts. As at 31 December 2015, customer deposits were £22.8bn compared to £29.9bn as at 31 December 2014.

Retail deposits reduced over the period by £5.8bn. 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; £3.4bn of the reduction relates to retail term deposits.

The total amount of corporate deposits reduced by £0.5bn over the year. This was due to the planned reduction in Non-core liability balances.

	2015	2014	Change
	£m	£m	£m
Current accounts			
Retail	**3,808.3**	3,479.3	329.0
Corporate	**2,106.6**	2,346.1	(239.5)
Total current accounts	**5,914.9**	5,825.4	89.5
Instant access savings accounts			
Retail	**6,580.6**	7,936.9	(1,356.3)
Corporate	**486.1**	584.0	(97.9)
Total instant access saving accounts	**7,066.7**	8,520.9	(1,454.2)
Term deposits and bonds			
Retail	**4,277.3**	7,675.6	(3,398.3)
Corporate	**281.4**	431.6	(150.2)
Total term deposits and bonds	**4,558.7**	8,107.2	(3,548.5)
Individual savings accounts (ISA)			
Retail – ISA Fixed	**2,355.9**	3,557.4	(1,201.5)
Retail – ISA Demand	**2,622.6**	2,745.9	(123.3)
Total ISA accounts	**4,978.5**	6,303.3	(1,324.8)
Other deposits	**290.6**	1,121.0	(830.4)
Total customer deposits	**22,809.4**	29,877.8	(7,068.4)

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.

In March 2015 the Bank optionally redeemed the Silk Road Finance Number One securitisation with an outstanding note balance of £1.1bn, of which £0.4bn was held by external investors. The Bank issued £250m of Tier 2 notes and repaid £443.4m (€550.0m) of Euro Medium Term notes at maturity during the year.

In addition, the Bank redeemed the fully retained Leek 20, 21 and 22 and Cambric 1 securitisations in the period, which unencumbered the underlying Non-core mortgages. In accordance with IAS 39 no funding liability is shown for retained notes and these amounts are therefore excluded from the table below.

	2015	2014	Change
	£m	£m	£m
Preference shares, PSBs and subordinated debt	**457.0**	196.4	260.6
Secured funding	**2,091.0**	2,521.8	(430.8)
Repos	**671.3**	500.6	170.7
Market borrowing	**10.9**	46.0	(35.1)
MTNs	**404.9**	832.9	(428.0)
Total wholesale funding	**3,635.1**	4,097.7	(462.6)

The table does not include the Funding for Lending Scheme (FLS). Funding provided by the FLS at the end of the period was £150.7m. £198.6m of outstanding FLS funding was repaid in December 2015, as part of the Bank's continuing management of its funding profile. The remaining balance was repaid in January 2016.

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

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

	2015	2014	Change
	£m	£m	£m
Repayable in less than 1 month	**522.5**	84.8	437.7
Repayable between 1 and 3 months	**159.7**	334.4	(174.7)
Repayable between 3 and 6 months	**352.4**	–	352.4
Repayable between 6 and 9 months	**243.3**	–	243.3
Repayable between 9 and 12 months	**433.0**	389.8	43.2
Repayable between 1 and 2 years	**746.9**	1,028.1	(281.2)
Repayable between 2 and 5 years	**259.0**	942.1	(683.1)
Repayable in more than 5 years	**918.3**	1,318.5	(400.2)
Total external funding	**3,635.1**	4,097.7	(462.6)

Deleveraging the Non-core Optimum business

The Bank's Revised Plan accepted by the PRA in December 2014, required a reduction in Non-core assets, which were particularly vulnerable to the Bank of England's hypothetical severe stress. The reduction in the size of the Optimum portfolio has significantly improved 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 One). On 25 September 2015 the Bank completed a further whole structure securitisation of Warwick Finance Residential Mortgages Number Two plc (Warwick Finance Two).

Warwick Finance One and Warwick Finance Two comprised portfolios totalling £3.1bn, of 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 of Warwick Finance One and 80% on the settlement of Warwick Finance Two. The Class A Note retention is the only position retained by the Bank within the Warwick Finance One and Warwick Finance Two capital structures. These assets are classified as available for sale. The net funding proceeds to the Bank for the publicly placed notes was £1.3bn.

The successful completion of the transactions formed a key component of the Bank's Revised Plan to accelerate the deleveraging of its Non-core assets, which includes Optimum.

Overall impact of the Warwick Finance One and Warwick Finance Two transactions

The table below shows the effect of the Warwick Finance One and Warwick Finance Two transactions on Optimum's balance sheet:

Optimum balance sheet

	31 December 2014[1] £m	Contractual repayments £m	Redemptions £m	Possession sales £m	Allowance for losses[2] £m	Fair value amortisation £m	Fair value accounting reclassification £m	Other £m	**Pre-Warwick 31 December 2015 £m**	Impact of Warwick Finance 1 & 2 transactions £m	**31 December 2015[1] £m**
Optimum Balance Sheet											
Gross customer balances	6,450.1	(51.4)	(346.1)	(21.4)	–	–	–	–	**6,031.2**	(3,144.5)	**2,886.7**
Allowance for losses	(21.9)	–	–	–	21.0	–	(48.0)	–	**(48.9)**	35.7	**(13.2)**
Fair value adjustments	(76.3)	–	–	–	–	2.8	48.0	0.1	**(25.4)**	9.8	**(15.6)**
Other accounting adjustments	4.3	–	–	–	–	–	–	(0.9)	**3.4**	–	**3.4**
Net carrying value	6,356.2	(51.4)	(346.1)	(21.4)	21.0	2.8	–	(0.8)	**5,960.3**	(3,099.0)	**2,861.3**

1. Refer to Risk Management section for further information on loans and advances to customers.
2. £21m decrease in allowance for losses, including parameter refresh and improvement in underlying asset

quality.

The cash proceeds from Warwick Finance One and Warwick Finance Two were £3.1bn (after £78.7m creation of the general reserves), giving rise to a £68.5m loss on disposal of £3.1bn gross loans and advances before the associated release of credit risk provisions, fair value reserves and transaction costs. Incorporating these elements, the overall net loss was £34.6m.

The table below shows the combined effect of the two Warwick Finance transactions on the Bank's income statement:

Warwick transactions – Bank 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	**31 December 2015 £m**
(Losses)/gains on asset sales[2]	(68.5)	35.7	(8.8)	–	(11.6)	**(53.2)**
Operating (expense)/income	(68.5)	35.7	(8.8)	–	(11.6)	**(53.2)**
Impairment losses on loans and advances[3]	–	–	–	(7.6)	–	**(7.6)**
Operating result	(68.5)	35.7	(8.8)	(7.6)	(11.6)	**(60.8)**
Conduct/legal risk	–	–	8.8	–	–	**8.8**
Fair value amortisation release	–	–	–	17.4	–	**17.4**
Profit/(loss) before taxation	(68.5)	35.7	–	9.8	(11.6)	**(34.6)**

1. £8.8m conduct risk provision was transferred to Warwick Finance One and Warwick Finance Two as part of the transaction. This is excluded from the loss recognised on transfer date in note 41.
2. £53.2m total loss on asset sale is reflected in Non-core (losses)/gains on asset sales.
3. £7.6m impairment losses on loans and advances is reflected in Non-core impairment gains/(losses) on loans and advances.

Impact on regulatory capital

The table below shows the effect of the Warwick Finance One and Warwick Finance Two transactions on the Bank's credit RWAs:

Capital

	31 December 2014 £m	Disposal of Optimum assets £m	Warwick Finance 1 & 2 Class A Notes £m	Other Movements £m	**31 December 2015 £m**
Optimum credit RWAs	3,526.0	(1,712.4)	–	(837.6)	**976.0**
Warwick Finance One & Two RMBS credit RWAs[1]	–	–	101.2	–	**101.2**
Total	3,526.0	(1,712.4)	101.2	(837.6)	**1,077.2**

1. Warwick Finance One and Warwick Finance Two RMBS are held within the Bank's Treasury business unit.

On completion, Warwick Finance One and Warwick Finance Two transactions contributed a net £1.6bn reduction in credit RWAs together with a net £17.2m reduction in CET1 as a result of the net loss of £34.6m on the disposal of assets, which was partially offset by the reduction of £17.4m in Expected Loss (EL) Gap.

Fair value of the Optimum portfolio

Within the Optimum portfolio, the majority of assets and liabilities are measured at amortised cost in accordance with the Bank's accounting policies as outlined in note 1 of the Bank's Financial Statements. The carrying value represents the gross customer balances less any allowance for losses and merger fair value adjustments, the value as at 31 December 2015 was £2.9bn (31 December 2014: £6.4bn).

The fair value of these Optimum assets and liabilities are as per note 39. This has 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.

Fair value

	31 December 2015		31 December 2014	
	Carrying Value £m	**Fair Value £m**	Carrying Value £m	Fair Value £m
Optimum				
Loans and advances to customers	**2,861.3**	**2,556.6**	6,356.2	5,113.1

The table above shows that the fair value of the Optimum portfolio is £304.7m lower than the carrying value as at 31 December 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 future portfolio purchase call to the residual noteholders in the Warwick Finance One and Warwick Finance Two transactions. If the notes are called, there may be potential for the residual noteholders to extract further value from the portfolio through alternative mortgage servicing arrangements.

Furthermore, the nature of the Warwick Finance One and Warwick Finance Two transactions, 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 and anticipated supply.

In summary, the fair values reported in note 39 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.

Optimum stress resiliency

The underlying stressed resiliency of the Optimum portfolio has improved since the 2014 Bank of England stress testing exercise. Improvements in the economic environment have resulted in an improvement in the underlying credit quality of the Optimum assets through reductions in the average Loan to Value of the portfolio and a reduction in the proportion of the book in arrears. The portfolio is therefore considered to be more resilient to a severe economic stress than at the time of the 2014 stress testing exercise.

Furthermore in the current market, the Bank believes it may not achieve similar pricing to that of the Warwick Finance One and Warwick Finance Two on future securitisations and thus any further deleverage in the near term would be capital destructive. The Bank's strategy is therefore to continue to hold these assets for the foreseeable future, in order to mitigate any further losses resulting from the sale of the assets and protect income and CET1 capital in a lower for longer base rate environment. However the bank will reassess this position, considering market conditions over time.

Revised basis of preparation

The results presented here are on a management accounts basis and are representative of how the Bank was managed in 2015.

The basis of preparation of the Bank's management and Board reporting has changed in 2015. The Income Statement breakdown has been revised to provide management with a more appropriate divisional split of underlying business unit profitability. This has allowed increased focus on the Core Bank and will enable a more informed comparison of the underlying operating performance drivers, following completion of the Bank's turnaround.

Legacy issues and the associated costs are now presented below the line, as these are not considered to comprise a material part of the go forward Core Bank operating result.

The following changes have been applied to the prior basis of operating expenditure, project expenditure and Financial Services Compensation Scheme (FSCS) levy.

The FSCS levy was previously reported as an exceptional item but is now included in operating expenditure as it is considered an on-going cost of operating the Core Bank.

Projects are split into three categories; Operational projects, Remediation projects and Strategic projects. Previously all project expenditure was included within the operating result and all depreciation and amortisation was included within operating expenditure. Under the revised basis of preparation, depreciation and amortisation of any capital spend associated with Strategic and Remediation projects are presented below the operating result. They are not considered to be recurring in the long term and will significantly reduce following the completion of the turnaround. Operating projects and the associated depreciation and amortisation continue to be included within the operating result.

Operating expenditure continues to be split into direct operating expenses, relating to each business unit, and head office overheads. The latter is included within the Core Bank result as these costs will be fully absorbed into the Core Bank upon completion of the Bank's Updated Plan.

Fair value accounting unwinds relating to the merger with Britannia Building Society, primarily the Leek notes are excluded from the operating result and included in the Non-core result.

Conduct and legal risk charges that relate to legacy issues are still excluded from the operating result.

2015

	Prior Basis £m	Reclass project depreciation £m	Reclass FSCS Levy £m	**Current Basis £m**
Total direct costs	(191.0)	11.0	-	**(180.0)**
Operations and Head Office overheads	(315.7)	22.7	(18.9)	**(311.9)**
Total operating costs	(506.7)	33.7	(18.9)	**(491.9)**
Operating projects	(27.0)	(22.7)	-	**(49.7)**
Remediation projects	(121.0)	(3.5)	-	**(124.5)**
Strategic projects	(92.2)	(7.5)	-	**(99.7)**
Total project expenditure	(240.2)	(33.7)	-	**(273.9)**
FSCS Levy	(18.9)	-	18.9	**-**
Total Costs	(765.8)	-	-	**(765.8)**

2014

	Prior Basis £m	Reclass project depreciation £m	Reclass FSCS Levy £m	Current Basis £m
Total direct costs	(225.6)	12.8	-	(212.8)
Operations and Head office overheads	(369.0)	37.8	(24.4)	(355.6)
Total operating costs	(594.6)	50.6	(24.4)	(568.4)
Operating projects	(37.2)	(33.8)	-	(71.0)
Remediation projects	(140.1)	(5.5)	-	(145.6)
Strategic projects	(49.2)	(11.3)	-	(60.5)
Total project expenditure	(226.5)	(50.6)	-	(277.1)
FSCS Levy	(24.4)	-	24.4	-
Total Costs	(845.5)	-	-	(845.5)

Total Bank financial performance

Bank performance

	2015 £m	Re-presented[2] 2014 £m	Change £m
Net interest income	**471.5**	493.4	(21.9)
Losses on asset sales	**(121.4)**	(14.4)	(107.0)
Non-interest income	**69.9**	115.1	(45.2)
Operating income	**420.0**	594.1	(174.1)
Operating expenditure	**(491.9)**	(568.4)	76.5
Operational project expenditure	**(49.7)**	(71.0)	21.3
Impairment gains on loans and advances	**48.6**	171.7	(123.1)
Operating result	**(73.0)**	126.4	(199.4)
Remediation project expenditure	**(124.5)**	(145.6)	21.1
Strategic project expenditure	**(99.7)**	(60.5)	(39.2)
Share of post tax profits from joint ventures	**0.7**	0.6	0.1
Conduct/legal risk	**(193.7)**	(101.2)	(92.5)
Fair value amortisation	**(120.4)**	(83.9)	(36.5)
Loss before taxation	**(610.6)**	(264.2)	(346.4)
Net interest margin	**1.42%**	1.22%	0.20%
Cost income ratio[1]	**100.0%**	105.1%	(5.1%)

1. Operating expenditure and operating projects (including associated depreciation and amortisation) divided by operating income excluding (losses)/gains on asset sales.

2. As a result of a change in accounting policy in the year, there has been a re-classification of income from net interest income to non-interest income. See Bank Income Statement for additional information.

The 2015 financial results reflect the positive progress made in delivering against the primary areas of focus outlined in the Bank's Revised Plan.

The Bank has achieved significant deleverage in its Non-core portfolios in 2015. The whole structure securitisations of Warwick Finance One and Warwick Finance Two totalled £3.1bn and reduced the Optimum book to almost half the size of the 2014 position. Corporate CoAM assets were also significantly reduced via a combination of formal trade sales, proactive rebanking of Corporate CoAM clients and the natural run off of the loans within the book.

In addition, the Bank issued £250m of Tier 2 capital notes, in 2015, which further increased capital resiliency.

Despite the significant asset deleverage the Bank has continued to improve its net interest margin delivering a 20bps improvement, to 1.42%. This improvement was largely driven by changes in deposit pricing within the Core Bank term and variable savings portfolios. The Bank has proactively managed down the higher levels of liquidity built up across 2014 as the overall funding requirement has reduced, following the deleveraging of Non-core assets.

This has resulted in a reduction in the Bank's underlying funding costs which has helped to protect net interest income, in light of the reduction in asset balances compared to 2014.

Non-interest income has reduced year on year, predominantly within the Retail business, driven by: a significant reduction in Link commission fees following the disposal of the majority of the ATM estate, industry-wide reductions in card interchange fees and lower overdraft fees following the launch of the new overdraft proposition in April 2015.

The Bank has delivered a significant reduction in operating expenditure which was down £76.5m in 2015 reflecting the progress of cost reduction initiatives. The reductions in costs are as a result of improved efficiency and simplification of Bank processes, reflecting management actions taken to address the Bank's cost base. Primarily attributable to the reduced ATM estate and cost reduction initiatives including: branch rationalisation, FTE (full time equivalents) reductions, third party procurement savings, supplier contract management and the fraud recovery process. The Bank has made a significant investment, with expenditure of £273.9m in 2015 to progress the transformation of IT resilience and remediation of systems and processes, in transforming the business into a stable retail and SME Bank with efficient processes and simplified products. The Bank has invested heavily in digital channels, through the upgrade of the mobile banking app, delivery of the paperless statements functionality, and digital product offerings.

Losses on asset sales have increased year on year to £121.4m, following increased amounts of Non-core deleverage in 2015 to improve stress capital resilience. The Bank has continued to invest across all project categories, continued to transform the Core Bank's operations and rebuild the Core Bank. Despite the progress made, significant challenges remain in creating a resilient Bank.

The Bank's financial performance continued to be impacted by legacy issues, particularly the anticipated fair value unwind related primarily to the merger with Britannia Building Society of £120.4m, and continued conduct legal risk charges totalling £193.7m in 2015, an increase of £92.5m from 2014.

The Bank's statutory loss before taxation for 2015 is £610.6m.

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

Operating expenditure

	2015	Re-presented 2014	Change
	£m	£m	£m
Core direct costs	**(165.2)**	(188.6)	23.4
Non-core direct costs	**(14.8)**	(24.2)	9.4
Total direct costs	**(180.0)**	(212.8)	32.8
Operations and Head office overheads	**(311.9)**	(355.6)	43.7
Total operating costs	**(491.9)**	(568.4)	76.5
Of which: staff costs	**(217.8)**	(250.6)	32.8

Total operating expenditure reduced by £76.5m to £491.9m. Following the change in the basis of preparation, operating expenditure now includes charges in respect of the FSCS levy. For more detail on the basis of preparation see page 21.

In line with the Core Bank strategy cost savings result from a channel shift to Digital for new and existing customers and a simpler product set. In 2015, this has been delivered through a rationalisation of branches and contact centres delivering savings of £8.7m. In addition Full time equivalents reductions driven by efficiencies, process simplification and the outsourcing of mortgage servicing to Capita in August 2015 delivered savings of £14.5m and the active management of supplier contracts delivered savings of £6.6m. These cost savings were partially offset by an increase in marketing expenditure of £6.4m relating to the continued promotion of the brand and an increase in Digital marketing, following the launch of new products.

The deleveraging of the Non-core portfolio has driven a significant reduction in the number of specialist contractors and lower consultancy fees (£5.4m) and reduced third party costs (£2.1m).

Cost reductions in Operations and Head Office overheads have been primarily driven through the rationalisation of the ATM estate (£30.3m); reduction in staff and 3rd party costs of £8.9m due to Capita outsourcing and other efficiencies and process simplifications and £5.4m reduction in the FSCS Levy. There were also one off non-recurring savings of £5.9m relating to property disposals and provision releases in the Operations and Head Office area. These savings have been partially offset by the Capita outsourcing costs of £7.1m.

At a total Bank level, Operating staff costs have decreased year on year by £32.8m to £217.8m. Permanent staff numbers (full time equivalents) have fallen by 1,012 to 4,470 and direct pay has fallen by £19.6m. In addition, the number of short to medium term specialist contractors has significantly reduced by 252 to 234 and as a result non direct pay has fallen by £13.3m. Note these exclude any FTE and associated expense relating to the Bank's project expenditure.

Project expenditure

	2015 £m	Re-presented 2014 £m	Change £m
Operational projects expenditure	**(27.0)**	(37.2)	10.2
Operational projects depreciation	**(22.7)**	(33.8)	11.1
Operational projects	**(49.7)**	(71.0)	21.3
Remediation projects expenditure	**(121.0)**	(140.1)	19.1
Remediation projects depreciation	**(3.5)**	(5.5)	2.0
Remediation projects	**(124.5)**	(145.6)	21.1
Strategic projects expenditure	**(92.2)**	(49.2)	(43.0)
Strategic projects depreciation	**(7.5)**	(11.3)	3.8
Strategic projects	**(99.7)**	(60.5)	(39.2)

Operational projects

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

The charge for the year of £49.7m (2014: £71.0m) of which £22.7m (2014: £33.8m) relates to depreciation of previous investments. Key current projects include: Regulatory Reporting Programme (£6.4m); Bank Corporate Simplification (£2.6m); cheque imaging (£1.1m) and (£16.9m) on other smaller projects, ensuring regulatory and mandatory requirements of the Bank are met.

Depreciation has reduced by £11.1m due to the transfer of shared assets to The Co-operative Group as part of separation. The depreciation charge has now been replaced with a management recharge which is included in operating expenses.

Remediation projects

Remediation projects relate to IT remediation and resiliency as well as activity associated with Bank separation.

The 2015 cost of £124.5m (2014: £145.6m) includes depreciation of £3.5m (2014: £5.5m). Key projects include: Enterprise Services Outsourcing and separation from The Co-operative Group £44.4m, in 2015 and £50.8m utilisation of 2014 provision; finance transformation programme of £14.1m; ongoing IT remediation of £10.6m of other issues identified and outlined by the PRA.

Strategic projects

Strategic projects relate to those projects that are transformational in nature and deliver significant cost or income benefits to the business. Project costs of £99.7m (2014: £60.5m), including depreciation of £7.5m (2014: £11.3m), reflect continued investment to enhance capability across the organisation. Projects included: further branch transformation, with closure of an additional 58 branches in 2015 (£15.6m), mortgage outsourcing (£33.1m), and digital (£16.0m), along with severance associated with organisational design changes (£8.0m).

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

Capital expenditure

		Re-presented	
	2015	2014	Change
	£m	£m	£m
Operational projects	**6.5**	(3.0)	9.5
Remediation projects	**9.1**	(2.5)	11.6
Strategic projects	**45.5**	26.0	19.5
Total project capital expenditure	**61.1**	20.5	40.6

Operational projects capital expenditure in 2015 relates mainly to cheque imaging. The 2014 position includes impairments of £5.8m with £3.4m relating to mobile banking.

Remediation capital expenditure in 2015 is driven by Enterprise License Agreement (ELA) (£7.8m) as part of Enterprise Services Outsourcing (ESO) project and finance transformation software license spend (£1.7m). 2014 included impairments of £5.8m for IT branch infrastructure.

Strategic capital expenditure in 2015 includes the digital programme costs of £22.8m (2014: £21.0m); additional capital spend relating to Mortgage outsourcing of £21.0m.

Impairment gains and losses

	2015	2014	Change
	£m	£m	£m
Core impairments	**(0.3)**	3.5	(3.8)
Non-core impairments	**48.9**	168.2	(119.3)
Net impairment gains on loans and advances	**48.6**	171.7	(123.1)

Net impairment write-backs of £48.6m in 2015 are much lower in comparison to 2014.

Non-core assets have been disposed of at favourable prices compared to the provision levels of impairment held against them, and together with a number of loan restructures, have resulted in the release of previously recognised impairment provisions resulting in a write-back of £65.8m in 2015 (2014: £104.6m). In addition, the Bank has benefited from revised valuations of collateral still held against assets, due to a marginal improvement in economic conditions. This has resulted in a net write-back of £5.8m (2014: £62.3m).

New defaults amounted to £43.0m in 2015, compared to £18.7m in 2014. This was driven by two specific cases moving into default, which together accounted for £33.0m of the charge. Improving economic conditions have seen the remainder of the Non-core portfolio represent a lower default rate, resulting in a collective impairment write-back of £20.4m in 2015 (2014: £33.2m).

Core Bank impairments of £0.4m, with the BaCB portfolio experiencing impairment write backs of £1.3m in the year following changes in the collective provision modelling.

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

Conduct and legal risk

Conduct and legal risk charges

	2015 £m	2014 £m	Change £m
CCA Customer Redress	**(58.3)**	(40.5)	(17.8)
CCA Cost to Remediate	**(40.4)**	(22.3)	(18.1)
PPI Redress	**(44.2)**	(5.0)	(39.2)
PPI Cost to Remediate	**(27.6)**	–	(27.6)
Packaged Accounts	**(16.8)**	(17.4)	0.6
Mortgages	**(0.6)**	(17.2)	16.6
Mis-sold	**6.4**	10.0	(3.6)
Other	**(12.2)**	(8.8)	(3.4)
Total	**(193.7)**	(101.2)	(92.5)

The 2015 charges relating to conduct and legal risk were £193.7m (2014: £101.2m) driven by increases in existing provisions with no new material categories of conduct risk being identified. The conduct and legal risk charges predominantly relate to legacy issues that have continued to be recognised across the industry.

The £193.7m charge in the year primarily comprised of increases for PPI (including Plevin) of £71.8m, CCA unsecured unenforceable interest of £58.3m and £40.4m relating to the cost to redress customers.

The Bank completed its PPI proactive business review activity in 2015, with minimal amounts of redress to be paid in 2016. However there was an increase in the underlying provision of £71.8m, driven by the level of inbound complaints not declining as originally anticipated and the proposed FCA led marketing campaign regarding the regulatory time barring on PPI complaints.

Following the recent FCA statement on Plevin, which outlined the proposed rules and guidance regarding the rules around redress that Banks likely to have to follow, the Bank has reassessed its exposure based on the information available currently and has recognised an incremental PPI provision of £1.3m.

The Bank also incurred a £58.3m cost in 2015 relating to unenforceable interest which it cannot charge on accounts while they are not compliant with CCA. Whilst the Bank has made significant progress in redressing and remediating open non-compliant accounts in 2015, it has revised assumptions regarding total remediation based on the actual redress paid out in 2015, coupled with an increase in the expected delivery costs to complete the remediation programme, which has resulted in a £98.7m increase in the CCA conduct provision.

At the start of 2015, the Bank experienced an increased level of inbound packaged account complaints which resulted in the Bank raising a £16.8m provision.

In addition, the Bank released £8.8m of provisions in relation to mortgages within the Optimum portfolio as a result of Warwick Finance One and Warwick Finance Two transactions. This is discussed in more detail on page 19.

Business segment financial performance

	2015 £m	Re-presented 2014 £m	Change £m
Retail contribution	**323.1**	348.5	(25.4)
BaCB contribution	**45.5**	48.0	(2.5)
Core contribution excluding Treasury/other	**368.6**	396.5	(27.9)
Treasury/other contribution	**(21.9)**	(48.5)	26.6
Core contribution result	**346.7**	348.0	(1.3)
Non-core contribution result	**(58.1)**	205.0	(263.1)
Head office overheads	**(311.9)**	(355.6)	43.7
Operational project costs	**(49.7)**	(71.0)	21.3
Operating result	**(73.0)**	126.4	(199.4)

Contribution is defined as net income after impairment and direct costs. Head office overheads (costs incurred in central functions) are not allocated to a business segment.

Core contribution excluding Treasury/other contribution is down on prior year at £368.6m (2014: £396.5m) as a result of a reduction in non-interest income, partially offset by lower direct costs.

Treasury/other loss improved by £26.6m primarily due to an increase in net interest income, which is a result of secured wholesale funding transactions being called in 2015.

Non-core contribution generated a loss of £58.1m (2014: profit of £205.0m). The primary driver of this deterioration is the accelerated deleverage strategy resulting in an underlying reduction in net interest income and increased loss on sale.

These are discussed in more detail in the following sections.

Internal transfer pricing policy

The Bank operates an internal transfer pricing policy. Liability balances receive an internal cost of funds as they provide the funding to support the Bank's assets. This is reflected within the business unit net interest income. The Bank's assets are charged an internal cost of funds to account for this. The internal cost of funds paid and received, varies by asset and liability type and is included within the business unit net interest income.

The internal cost of funds for Core Bank assets and liabilities is refreshed each year to reflect the Bank's underlying cost of funding. The underlying funding cost has reduced in 2015 compared to 2014 following the re-pricing of the Bank's relatively more expensive liabilities. Core assets have therefore been charged lower internal cost of funding and Core liabilities have received a reduced funding income. The internal interest rates for Non-core assets and liabilities do not change annually.

This has reduced the net interest income since 2014 of the Retail and BaCB business units as they have a net liability position.

Core

Core contribution

	2015 £m	Re-presented 2014 £m	Change £m
Net interest income	**460.6**	444.8	15.8
Losses on asset sales	**(0.8)**	(2.1)	1.3
Non-interest income	**52.4**	90.4	(38.0)
Net income	**512.2**	533.1	(20.9)
Direct costs	**(165.2)**	(188.6)	23.4
Impairment gains/(losses) on loans and advances	**(0.3)**	3.5	(3.8)
Contribution result	**346.7**	348.0	(1.3)
Head office Overheads	**(311.9)**	(355.6)	43.7
Operational projects	**(49.7)**	(71.0)	21.3
Operating result	**(14.9)**	(78.6)	63.7
Net interest margin[1]	**1.91%**	1.65%	0.26%
Assets	**22,819.0**	25,476.2	(2,657.2)
Liabilities	**25,674.6**	33,391.0	(7,716.4)

1. Total Core Asset and Liability net interest income divided by average asset balances.

Core Bank contribution, comprising of Retail, BaCB and Treasury/other, reduced by £1.3m.

Retail contribution reduced by £25.4m as a result of a reduction in non-interest income, partially offset by direct cost savings.

BacB contribution reduced by £2.5m as a result of a reduction in net interest income, driven by a reduction in internal cost of funding.

Treasury/other contribution increased by £26.6m similarly as a result of an increase in net interest income primarily due to secured wholesale funding transactions being called during the year.

These are discussed in more detail in the following sections.

Core Bank net interest margin has continued to improve year on year up 26 basis points (bps) on prior year to 1.91%, largely driven by the reduction in interest expense on liabilities following proactive repricing.

Core Bank assets have reduced by £2.7bn to £22.8bn mainly attributable to a £2.2bn reduction in Treasury/other assets including the removal of £0.5bn of Unity Trust Bank assets that were previously consolidated into the Bank's balance sheet.

Core Bank liabilities have reduced by £7.7bn during the year from £33.4bn at 31 December 2014 to £25.7bn at 31 December 2015 as the Bank has proactively managed liability run-off to meet reduced funding and liquidity requirements.

Retail contribution

	2015 £m	Re-presented 2014 £m	Change £m
Net interest income	**421.7**	396.3	25.4
Non-interest income	**43.2**	105.2	(62.0)
Net income	**464.9**	501.5	(36.6)

Direct costs	**(138.1)**	(154.8)	16.7
Impairment gains/(losses) on loans and advances	**(3.7)**	1.8	(5.5)
Contribution result	**323.1**	348.5	(25.4)
Net interest margin[1]	**2.93%**	2.52%	0.41%
Customer assets	**14,219.3**	14,611.4	(392.1)
Customer liabilities	**19,725.2**	25,562.3	(5,837.1)

1. For each individual Business segment the Net interest margin calculation adds net interest earned on both assets and liabilities together and divides by average asset balances, this is not adjusted to reflect any balance sheet mismatch at Business segment level.

Retail contribution has reduced by £25.4m to £323.1m (2014: £348.5m), as higher net interest income and reduced direct operating expenses have been more than offset by a £62.0m reduction in non-interest income.

The Retail business continues to benefit from the increased new business origination activities in the year. This renewed focus has helped drive an increase in mortgage completions to £2.8bn in 2015 compared to £1.1bn in 2014. The Bank's intermediary channel accounted for 88% or £2.5bn of total mortgage completions in 2015 (2014: £0.9bn), with £1.5bn in the second half of 2015 as the Bank's offering becomes more competitive in this segment. Total mortgage redemptions decreased in 2015 to £2.3bn down slightly from £2.4bn in 2014. The mortgage portfolio had a net reduction of £0.2bn in the year (£1.9bn reduction in 2014).

The completion of mortgage processing outsourcing should further improve the Bank's ability to process mortgage applications and introduce enhanced retention capability.

The Bank's current account volumes have stabilised, compared with a 4.0% reduction in 2014. This is primarily as a result of the Bank's increased presence within the marketplace following investment in an improvement in the brand positioning, and significant improvements in the Bank's Net Promoter Score (NPS) for Current Accounts.

Net interest income has increased by £25.4m to £421.7m in 2015.

The large scale deleveraging of Non-core assets has reduced the Bank's overall funding requirements, as the Retail portfolio was the largest source of funding for these Non-core assets. As a result, the Bank has been able to proactively manage a reduction in high priced deposits and rebalance the savings portfolio, through the reduction in pricing for term and variable deposits. This has resulted in a reduction in the average interest expense on deposits and a more sustainable cost of funding. This activity has seen Retail customer liabilities reduce by £5.8bn to £19.7bn (2014: £25.6bn).

Retail net interest income has reduced in 2015 as a result of the changes in the internal cost of funding as outlined on page 24 in the internal transfer pricing policy section. Net interest income has also fallen as a result of the reduction in Retail liabilities, on which the internal cost of funding has been paid.

The reduction in net interest income from these impacts has however been more than offset by the reduction in level of interest expense paid for Retail customer deposits following the repricing activity within the year.

Despite a significant reduction in the volume of liabilities, driven by a reduction in the Bank's funding requirements and the reduction in the internal cost of funding, the Retail portfolio has seen an increase in net interest income and net interest margin.

Retail non-interest income reduced to £43.2m (2014: £105.2m), primarily due to a reduction in income from Link commission as a result of the sale of part of the ATM estate. In addition, industry-wide impacts of revised card interchange have reduced the Bank's card transaction fee income. Overdraft fees have decreased following the launch of the new overdraft proposition in April 2015.

The impairment charge for Retail was £3.7m; this was predominantly within the unsecured portfolio, with overall write-backs in the secured portfolio following improvements in the underlying impairment model parameters in 2015.

Business and Commercial Banking (BaCB)

Business and Commercial Banking contribution

	2015	Re-presented 2014	Change
	£m	£m	£m
Net interest income	**41.9**	46.1	(4.2)
Non-interest income	**11.6**	14.9	(3.3)
Net income	**53.5**	61.0	(7.5)
Direct costs	**(9.3)**	(14.6)	5.3
Impairment gains on loans and advances	**1.3**	1.6	(0.3)
Contribution result	**45.5**	48.0	(2.5)
Net interest margin[1]	**7.35%**	6.29%	1.06%
Customer assets	**520.9**	620.0	(99.1)
Customer liabilities	**2,682.0**	2,837.0	(155.0)

1. For each individual Business segment the Net interest margin calculation adds net interest earned on both assets and liabilities together and divides by average asset balances, this is not adjusted to reflect any balance sheet mismatch at Business segment level.

2015 BaCB business contribution of £45.5m (2014: £48.0m) represents a £2.5m reduction on prior year.

Customer liabilities have fallen to £2.7bn, mostly driven by the run off on the fixed savings book. Customer assets decreased from £620.0m to £520.9m, largely due to customer outflows due to our competitive position within the market place.

Net interest income reduced to £41.9m in 2015 down £4.2m from 2014. BaCB generates the majority of its net interest income from its liability balances and as outlined on page 24 changes in the internal transfer pricing policy in 2015 have reduced the internal cost of funding received by liabilities, reducing the overall net interest income.

The net liability position of the BaCB portfolio results in the net interest margin being sensitive to changes in asset balances.

The 106bps improvement in Net interest margin is driven by the proportionally higher impact of the reduction in asset balances in 2015 compared to the reduction in Net interest income for BaCB.

BaCB reported a net impairment write back of £1.3m driven by changes in the collective provision methodology.

Treasury/other

Treasury/other business contribution

	2015 £m	Re-presented 2014 £m	Change £m
Net interest income	**(3.0)**	2.4	(5.4)
Losses on asset sales	**(0.8)**	(2.1)	1.3
Non-interest income	**(2.4)**	(29.7)	27.3
Net Income	**(6.2)**	(29.4)	23.2
Direct costs	**(17.8)**	(19.2)	1.4
Impairment gains on loans and advances	**2.1**	0.1	2.0
Contribution result	**(21.9)**	(48.5)	26.6
Assets	**8,078.8**	10,244.8	(2,166.0)
Liabilities	**3,267.4**	4,991.7	(1,724.3)

Treasury/other contributed a loss of £21.9m in 2015 compared to the prior period loss of £48.5m.

Net interest income decreased by £5.4m, the positive impact of the lower wholesale funding was more than offset by lower interest income on reduced balances supporting the Bank’s liquidity buffer which consists of highly liquid eligible assets such as cash, gilts and multi-lateral development bonds. These balances reduced by £2.0bn when compared to 2014 reflecting the lower liquidity requirements of the Bank. In addition to this, the balance sheet deleveraging of the Non-core portfolio resulted in lower internal funding income charged to the rest of the business. Balance sheet reduction and a change in product mix have also had a positive impact on Treasury income through hedging.

The disposal of Western Mortgage Services (WMS) to Capita, completed in August 2015, as part of the mortgage processing outsourcing agreement generated a gain on sale of £4.3m in 2015.

In December 2015, the Bank reduced its share in Unity Trust Bank, to 6.7%. Prior to the sale Unity Trust Bank results were fully consolidated into the Bank’s results. The Bank received £5.9m of cash proceeds from Unity Trust Bank following the sale of £3.3m Class A Shares. The overall loss on sale was £5.0m.

Non-interest income improved due to significant positive hedge ineffectiveness on cross currency swaps. This was primarily due to the weakening of the euro against sterling. In addition to this the FLS facility was partially repaid resulting in lower fees paid.

The Bank purchased £1.6bn of the Warwick Finance One and Warwick Finance Two RMBS senior tranche as part of the Optimum asset disposal programme. In addition to this a £250m Tier 2 subordinated debt issuance was successfully completed while senior unsecured debt of (£443.4m) €550.0m was repaid in 2015.

Non-core

Non-core balance sheet

	2015	2014	Change
	£m	£m	£m
Corporate CoAM	**1,998.0**	3,930.1	(1,932.1)
Optimum	**3,155.9**	6,822.9	(3,667.0)
Assets	**5,153.9**	10,753.0	(5,599.1)
Corporate CoAM	**211.3**	557.4	(346.1)
Liabilities	**211.3**	557.4	(346.1)
Customer assets	**4,894.5**	10,253.1	(5,358.6)
Customer liabilities	**211.3**	557.4	(346.1)

Non-core total assets decreased by £5.4bn to £4.9bn. The Bank's Revised Plan required an acceleration of the reduction in Optimum assets. Optimum was particularly vulnerable to the 2014 Bank of England's hypothetical severe stress. The accelerated reduction of the Optimum portfolio significantly improved the Bank's resilience to a severe economic downturn. Current market conditions mean it is not capital accretive to further deleverage the Optimum Portfolio in the near term.

The Bank's Non-core residential mortgage portfolio reduced by £3.7bn to £3.2bn primarily driven by the two whole structure securitisations of Warwick Finance One and Warwick Finance Two.

Deleveraging of Corporate CoAM assets continued in 2015, with a net reduction of £1.9bn across 2015. This reduction is mainly driven by the sale of loans to third parties and the re-banking of customers. This included the sale of the renewable energy portfolio of £264.0m and PFI sales of £445.7m.

Non-core liabilities have reduced by £346.1m to £211.3m in line with expectations. As the Bank continues its Non-core deleveraging strategy, customers have naturally migrated their accounts to their new financial institutions.

Non-core contribution

		Re-presented	
	2015	2014	Change
	£m	£m	£m
Net interest income	**10.9**	48.6	(37.7)
Losses on asset sales	**(120.6)**	(12.3)	(108.3)
Non-interest income	**17.5**	24.7	(7.2)
Net income	**(92.2)**	61.0	(153.2)
Direct costs	**(14.8)**	(24.2)	9.4
Impairment gains on loans and advances	**48.9**	168.2	(119.3)
Contribution result	**(58.1)**	205.0	(263.1)

Non-core contributed a loss of £58.1m in 2015, which is a significant but expected reduction from the positive contribution of £205.0m in 2014.

Non-core net interest income has decreased by £37.7m, following the significant reduction in interest generating assets as the book has been deleveraged.

The reduction in Non-core contribution is further impacted by lower net impairment write-backs on loans and advances in the year of £48.9m down from £168.2m in 2014. These are associated with assets being disposed of at favourable prices to the net book value resulting in the write back of previously recognised impairment provisions. In addition, the Bank has revised valuations of assets still held. 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 loss on sale has increased by £108.3m from 2014. This is predominantly driven by the losses on sale from the Corporate CoAM portfolio of £67.5m of which £30.6m relates to £445.7m of PFI, £14.9m relates to £56.4m of mortgage backed securities and £14.2m relates to a portfolio of £81.8m of Corporate assets, and also the Optimum mortgage securitisations.

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

Direct costs reduced by £9.4m to £14.8m in 2015, primarily as a result of a reduction in staff costs with fewer staff being required as the book is deleveraged. Coupled with the non-recurring costs of operating the Illius portfolio and the Non-core portfolio set up fees which both existed in 2014.

The Bank’s Updated Plan

The Bank has made steady progress in 2015 against the objectives of the Revised Plan, however throughout 2015 a number of systemic and idiosyncratic opportunities and challenges have driven deviations to the assumptions included within the Revised Plan.

These deviations have impacted the Bank’s 2015 actual performance and driven revised expectations across the planning horizon.

These include lower for longer market interest rates, improved Core Bank origination, prevailing market pricing for Non-core deleverage, systemic capital market volatility, increased 2015 provisions for conduct risk and further clarity around future Regulatory Capital requirements, including MREL.

Consequently, the Bank has undertaken a strategic review in order to assess a number of options open to management that enable the Bank to mitigate some of the impacts of these changes. This has resulted in the creation of the Bank’s Updated Plan which has been approved by the Bank’s Board and accepted by the PRA.

The key strategic change in the Bank’s Updated Plan compared to the Revised Plan relates to the Bank ceasing any further planned deleverage of the Non-core Optimum portfolio although management will retain this as a management action that can be redeployed if required.

The underlying stressed resiliency of the Optimum portfolio has improved since the 2014 Bank of England stress testing exercise. Improvements in the economic environment have resulted in an improvement in the underlying credit quality of the Optimum assets through reductions in the average Loan to Value of the portfolio and a reduction in the proportion of the book within arrears. The portfolio is therefore considered to be more resilient to a severe economic stress than at the time of the 2014 stress testing exercise and is significantly smaller in size.

Furthermore, given current market volatility, the Bank believes that it may not achieve similar pricing to that of the Warwick Finance One and Warwick Finance Two on future securitisations and thus any further deleverage in the near term would unnecessarily be capital destructive. The Bank’s strategy is therefore to continue to hold these assets for the foreseeable future, in order to mitigate any further losses resulting from the sale of the assets and protect income and CET1 capital in a lower for longer base rate environment. The Bank will continue to assess this strategy in light of emerging market conditions periodically.

There are still significant risks within the Bank’s Updated Plan. Legacy conduct risk issues continue to impact the industry whilst, along with all financial institutions, the Bank is significantly sensitive to changes in the macroeconomic environment.

The required remediation and transformation investment along with the continued unwind of the fair value reserves recognised following the merger with the Britannia Building Society is expected to drive further losses in the Bank in 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

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 Bank's capital position have been removed with the successful completion of several capital raising exercises, including the Liability Management Exercise (LME) in December 2013, the equity capital raising in May 2014, the receipt of the Co-operative Group's £333m capital contribution in 2014 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 for the period 2015-2019 under which one of the key priorities was to commit to an earlier deleverage of the Non-core Optimum portfolio, being a significant part of the Bank's Non-core business that is particularly vulnerable to the hypothetical stress tests. During 2015, the Bank successfully completed the Warwick Finance One and Warwick Finance Two RMBS securitisations with the effect of contributing a combined £1.6bn reduction in credit RWAs.

Overall, there remain significant challenges in the execution of the turnaround, although much progress has been made over the past 24 months. The Bank has a large number of remediation and redress programmes to implement (most notably a very large and complex project with respect to the Bank's IT infrastructure) along with substantial re-engineering of its operating model. 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, prospects, regulatory capital position and its ability to comply with its regulatory requirements both in respect of capital and more generally (see below for more information).

The Bank's ability to implement a turnaround is heavily influenced by external factors which may mean underpinning internal assumptions relating to economic or market conditions may be incorrect and negatively impact the Updated 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, such as Brexit), the management of credit risk, interest rate risk, currency risk and market risk, as well as risks stemming from regulatory change and an increasing regulatory enforcement and an increasingly litigious environment. A number of such factors have required the Bank to adapt its Revised Plan and replace it with the Updated Plan as discussed below.

The Bank's Updated Plan and Rationale for retaining Optimum

Throughout 2015, a number of external and idiosyncratic opportunities and challenges faced by the Bank have driven material changes to the assumptions that were included in the Revised Plan accepted by the PRA in December 2014. These changes have impacted the Bank's 2015 performance and resulted in revised assumptions and expectations across the Bank's planning horizon. This has resulted in an Updated Plan, for the period 2016-2020, which has been approved by the Bank's Board and accepted by the PRA.

The key changes to assumptions include lower for longer Bank of England interest rates, improved Core Bank origination, prevailing market pricing for Non-core deleverage, systemic capital markets volatility, increased

2015 provisions for conduct risks and further clarity around future regulatory capital requirements, including expectations concerning MREL.

Consequently, the Bank has undertaken a strategic review to assess the options available to mitigate some of the impacts of these changes. The key strategic change made in the Bank's Updated Plan relates to the suspension of any further planned deleverage of the Non-core Optimum portfolio in 2016 until such time as market conditions improve, at which point Management may consider opportunities at the time. Given current market volatility, the Bank believes it may not achieve similar pricing benefits to that of the Warwick Finance One and Warwick Finance Two transactions and thus any further deleverage of Optimum in the near term would be capital destructive.

Additionally, the underlying stressed resiliency of the Optimum portfolio has increased since the 2014 Bank of England stress testing exercise and the economic environment has contributed to an improvement in the underlying credit quality of the Optimum assets. These are due to reductions in the average loan to value ratio and a reduction in the proportion of the book within arrears. The size of the portfolio materially reduced and the remaining portfolio is considered to be more resilient to a severe economic stress than at the time of the 2014 stress testing exercise and pose less of a risk than previously thought.

The Bank's strategy is therefore to continue to hold the remainder of the Optimum portfolio assets for the foreseeable future in order to mitigate any further losses that may result from the sale of the assets and accordingly protect the Bank's income and CET1 capital in a lower for longer interest rate environment. The Bank will continue to assess this strategy in light of emerging market conditions periodically. There remain significant risks within the Bank's Updated Plan although much progress has been made over the past 24 months.

Optimum portfolio Risk Weighted Assets temporary adjustment

The Bank is seeking to enhance its credit modelling capability in a number of key portfolios and is in discussion with the PRA with regards to the approval and implementation of these enhancements during 2016. A major element of these enhancements relate to how the Bank determines LGD for retail secured mortgages.

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

Following the significant deleverage of the Optimum balances within 2015, the Bank has judged it appropriate to reduce the temporary adjustment from £1.0bn to £0.3bn in line with the balance reduction in order to ensure that the Optimum RWAs are more reflective of the underlying credit quality of the reduced size of the portfolio. The PRA has not objected to this change.

When the new LGD model is fully implemented, the remaining £0.3bn of the temporary adjustment is expected to be removed in full if agreed by the PRA with the new model directly calculating the appropriate LGD and corresponding RWAs for all the Bank's secured portfolios.

Regulatory Position

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 implements its Updated Plan. As part of the successful implementation of the Updated Plan, the Bank will need the ongoing support of all its Regulators regarding any continuing and intervening deficiencies to required regulatory standards.

Capital

The Bank continues to meet its Pillar 1 capital requirements under normal economic conditions. This is the minimum required under the CRR. The PRA provides Individual Capital Guidance (ICG) for each bank. This represents guidance on the capital (Pillar 2a) a firm should hold in excess of Pillar 1.

As at 31 December 2015, the Bank was compliant with ICG for total capital set by the PRA, however it is not forecast to remain compliant with ICG requirements for most of the planning period. The Bank is not expected to be sustainably ICG compliant until 2019.

The Bank does not currently have sufficient capital resources to withstand a severe stress scenario under its current in force PRA Buffer. The Bank's Updated Plan has been accepted by the PRA subject to ongoing review and the Bank expects to remediate this position by 2020. This is driven by further reductions in Non-core RWAs, the implementation of cost reduction initiatives and profit generation in the later stages of the Plan.

The Bank is mindful of the capital implications of the Bank of England's minimum requirement for own funds and eligible liabilities (MREL) regime and the increased debt issuance this will drive, for the banking industry in general but also for the Bank.

The Bank of England published a consultation paper in December 2015 proposing a methodology for setting a firm's individual MREL requirement at a minimum of 2 x (Pillar 1 + Pillar 2a).

The Bank's Updated Plan (2016-2020) incorporates MREL qualifying issuance commencing in 2018 which is the Board's current view of the earliest time when such issuance may be feasible. The PRA and the Bank of England have indicated their strong preference that the Bank incorporates an earlier profile of MREL issuance than currently contemplated by the Bank's Updated Plan. Such expectations have been confirmed by the regulators as not intended yet to represent the formal setting of a required MREL issuance plan and the Bank of England has stated that it will consult with the Bank before setting binding requirements, which it will be able to do at any point following publication of its MREL policy (expected to be sometime in 2016).

Should the Bank be able to issue MREL earlier than currently considered feasible, then it would do so, which might further delay ICG and PRA buffer compliance and Core Bank operating profitability. The PRA and Bank of England are aware of these possible outcomes. If in due course the Bank becomes subject to a binding requirement to issue MREL and it is unable to do so when required, the Bank's regulators can agree to accept the Bank's original issuance plan, a revised issuance plan, require some other action on the part of the Bank or in the absence of any of these the Bank of England may exercise its powers under the Banking Act 2009[1]. In considering the viability for Board has taken note of the contents of PRA consultation paper (CP 44/15) and the Board believes that resolution is less likely than the other outcomes while the Bank is executing its plan as accepted by the PRA and continuing to de-risk the Bank. [2]

1. Details of how the Bank of England's resolution powers operate under the Banking Act 2009 generally operate can be found set out in a document "The Bank of England's approach to resolution, October 2014" which can be found on its website at http://www.bankofengland.co.uk/financialstability/Documents/resolution/apr231014.pdf.
2. PRA CP 44/15 "The minimum requirements for own funds and eligible liabilities (MREL) Buffer and Threshold Conditions" was published on 11 December 2015 and sets out that PRA processes to adopt a policy that if a firm is in breach of its MREL requirement, it would not automatically mean that the PRA will consider the firm is failing, or likely to fail, to satisfy Threshold Conditions.

Both regulators acknowledge and recognise that any change to the Bank's current planning assumptions for MREL would have to be subject to the overall feasibility of the Bank being able to issue MREL which would need to take into account multiple factors including (without limitation): market conditions, investor appetite, pricing, the Bank's financial performance and plans, and its then existing capital position.

This issue will be kept under close review by the Board, the Bank of England and the PRA periodically over the life of the plan period.

There is no guarantee that the Bank's regulators will not enforce stricter regulatory capital requirements on the Bank (whether specifically applicable to the Bank or to banks more generally) or that the Bank will not be required to issue additional capital to satisfy MREL.

Capital Requirements Regulations (CRR)

The Bank is currently not compliant with CRR provisions related to the use of an Internal Ratings Based (IRB) approach to modelling its credit risk capital requirements. A review by the Regulator took place during 2015 and identified areas of non-compliance and inadequate procedures relating to use of an IRB approach requiring improvement and a remediation plan to rectify this under supervisory guidance. These areas include the redesign of model risk policy and model inventory and the strengthening of the overall control environment and governance relating to IRB approach.

Subsequently, the PRA has set the Bank an additional CRR-related Pillar 2a capital requirement in the form of a fixed add-on in order to cover any potential risk in this area. This Pillar 2a capital requirement was not included within the Bank's ICG requirements at 31 December 2015 however it will be included within the Bank's requirements going forward. It is the Bank's intention, subject to model output, to have the add on removed by the end of 2017 at the latest.

A failure to address Model Risk non-compliance could potentially result in further regulatory action such that the Bank's permission to use an IRB approach could be removed, resulting in the use of a standardised approach to modelling credit risk. This could expose the Bank to a material increase in the calculation of its RWAs with a consequent requirement to hold additional capital, the creation of an additional ICG deficit and a reduction in the Bank's CET1 ratio.

Liquidity Coverage Ratio (LCR)

The Bank is not currently compliant with all requirements to report its liquidity coverage ratio which came into force in October 2015. Specifically, the Bank is unable to report its LCR and Additional Liquidity Monitoring Metrics (ALMM) on a stand-alone Bank only basis due to a lack of data and systems capability at a subsidiary level to separate the Bank from a consolidated reporting level. The Bank expects to continue to report its LCR and ALMM on a consolidated level while it seeks to improve data and systems architecture to enable it to report on a stand-alone basis during 2016.

Technology

As reported previously, the Bank's IT infrastructure is in need of an upgrade in numerous respects. Previously, the Bank has reported many shortcomings in its ability to recover its systems in the event of failure in the technical infrastructure. Significant progress was made in 2015 to address these issues (95% of components have now been successfully proven), resulting in a material reduction in exposure to component-level failure of the IT infrastructure.

The migration of IT Infrastructure to an IBM platform (announced in January 2015) is expected, in time, to deliver proven disaster recovery capability for all critical business processes. In Q1 2015 the Bank received written confirmation from the FCA that the lack of proven end-to-end disaster recovery capability constituted a breach of the FCA's Threshold Conditions (Threshold Conditions[1]).

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

The FCA continues to closely supervise the Bank as it works towards the remediation of the historic deficiencies in its IT systems including, notably the disaster recovery capability mentioned above, and thereby restoring compliance with the appropriate resources (non financial resources) Threshold Conditions. The FCA is not currently proposing further immediate supervisory intervention or the immediate exercise of any additional regulatory powers as a result of this previous assessment. The assessment took place prior to the improvements that have been made during 2015. 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's Threshold Conditions. However, both the PRA and FCA are closely monitoring the position of the Bank and it remains in continual dialogue with both Regulators.

Risk Management Framework (RMF)

A supervisory review of the Bank's Risk Management Framework (RMF) was conducted during 2015 and concluded that further work is required to fully embed it across the Bank. While the Bank's systems of control have improved since 2014 and steps have been taken during 2015 to enhance the RMF, significant further strengthening is required in order to fully and effectively embed the RMF to a consistent standard across the Bank. There remain challenges to finalising the implementation of the RMF including the capability of systems to effectively report risks on an end-to-end basis and the ability to attract and retain staff with the requisite skills and knowledge into the first and second line Risk functions.

This continues to be a priority for the Bank in 2016 and the Regulators will continue to closely review the Bank's progress during 2016. A failure to implement an RMF that addresses any remaining material deficiencies could potentially result in the Regulators taking further action.

The table below outlines 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, operating results, financial condition, reputation and prospects.

The Bank's Risk Management Framework (RMF) categorises these risks and comprises the Board approved segmentation of the risks that the Bank faces. During 2015, the Bank refined and enhanced its risk appetite statements under the RMF against each risk to provide further clarity. These are more fully described in the risk management section of this report. The table below highlights ten principal risks, all of which are included in the RMF and 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. Please refer to the Performance Evaluation section of the Corporate Governance section of this report for a fuller discussion of the RMF.

Many of these risks are not unique to the Bank but are common across all banks. Detail on the risks that are more idiosyncratic to the Bank can be found below:

Principal Risks – Definition

1. 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.

Why this is important and how it is managed

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 macroeconomic, market-wide risks such as issues with the housing market and interest rate changes.

Principal Risks – Definition

2. 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.

Why this is important and how it is managed

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.

Principal Risks – Definition

3. 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.

Why this is important and how it is managed

The treasury team manages interest rate risk. More information can be found in the risk management disclosures. The Bank's deleverage strategy is particularly susceptible to market risk and has impacted the Bank's ability to continue to deleverage all of the Optimum portfolio.

Principal Risks – Definition

4. 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.

Why this is important and how it is managed

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:

The Bank's IT system has 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 IT disaster recovery plan is not proven for a significant and prolonged data centre outage. Whilst there has been a material improvement in the Bank's resilience to failure of individual components of its IT infrastructure, the Bank's ability to recover from a significant data centre outage remains unproven. 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 and timescales may exceed those originally contemplated. The Bank's regulators are fully aware of the steps the Bank is taking to address these operational risks.

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.

In 2015 the Bank commenced implementation of new financial systems which will be utilised to deliver the 2015 year end financial results. This, together with other process improvements has improved the control environment to some extent. This investment will continue in 2016 to mitigate inefficiencies and automate, where possible, certain of the Bank's financial processes as well as significantly improve the control environment.

The Bank's systems of control have been weak and although the foundations of more robust controls, including enhancements to the RMF in 2015 have been laid, this is taking more time than anticipated and significant work is still required 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 RMF 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.

The Bank is outsourcing key aspects of its operations for example its mortgage processing, 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 and delay means costs could increase. The Bank is exposed to the risk that any major outsourcing arrangements are not properly scoped by the Bank in determining its business requirements; the Bank fails to deliver on its contractual commitments; the 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 increased costs and/or disruption in its mortgage business which would impact on a major aspect of its core banking business. The Bank has engaged Capita to provide mortgage origination and servicing processing whilst retaining control over the policies to be applied by Capita. Until such time as business processing moves onto Capita systems (the testing, implementation and migration of which are subject to close supervision by the Bank), Capita shall continue to provide the services in the manner and to the same standard as performed by the Bank pre-outsourcing. The design and build of Capita systems is being worked on and until complete could lead to delays or increased costs. Business processing is expected to transfer onto Capita systems for new business on a phased basis with migration of existing business planned to take place in 2017.

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.

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.

Fraud Risk. The Bank will continue to manage fraud risk within risk tolerances, manage losses arising and comply with all relevant legal and regulatory requirements.

Principal Risks – Definition

5. Reputational risk

The risk associated with an issue which could in some way be damaging to the reputation of the Bank. Underlying issues 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.

Why this is important and how it is managed

The Bank considers that its reputation as an ethically led organisation is critical to the success of the plan. 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 ongoing 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 affecting The Co-operative Group. The Co-operative Bank trade mark belongs to the Bank. Please see the Branding Arrangements section of the Corporate Governance Report on page 58 for a fuller explanation of the principles governing the Bank's right to use the trade mark and the circumstances in which the Group may be able to conduct banking business.

In certain circumstances the Bank's right to use the term 'Co-operative' could be challenged or removed. The Secretary of State for Business, Innovation and Skills may direct the Bank to change its registered name if, in his or her opinion, it gives so misleading an indication of the nature of its activities as to be likely to cause harm to the public. Further, the FCA has the power to prevent the use of the term 'Co-operative', or to take other action regarding the Bank's branding, if the FCA considers this desirable to protect consumers, to promote competition in the interests of consumers or to protect the integrity of the UK financial system. A loss of support from key stakeholders for the Bank's continued use of the term Co-operative may result in a risk these authorities could look to exercise their powers.

Co-existence Agreement – Bank and Group have been negotiating a co-existence agreement to allocate trademarks into appropriate ownership. As the agreement is not yet finalised, there is still scope for disagreements on the use of certain shared brands. In addition, if terms cannot be agreed, the Bank may be required to make rapid changes to its IT systems, marketing materials and signage.

Principal Risks – Definition

6. 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 Updated 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 2, specifically execution, concentration and liquidity risk.

Why this is important and how it is managed

The Bank's Updated Plan to focus on becoming a smaller Core Bank is challenging, unproven and is in the earlier stages of implementation. The Bank does not have a track record in successful execution of the large scale change simultaneously necessary. Accordingly, there is an ongoing risk that the Bank is unable to implement the turnaround. Furthermore, there is a risk that the Bank's strategy to deliver the Updated Plan may be insufficient to address all of the Bank's problems or deliver the projected benefits.

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.

The Bank's Updated Plan will require the Bank to continue to deleverage Corporate CoAM assets and reduce execution risk across key transformation projects, which it may not be able to achieve.

If in due course the Bank becomes subject to a binding requirement to issue MREL and it is unable to do so when required, the Bank's regulators can agreed to accept the Bank's original issuance plan, a revised issuance plan, requires some other action on the part of the Bank or in the absence of any of these the Bank of England my exercise its powers under the Banking Act 2009. In considering viability the Board has taken note of the contents of the PRA consultation paper (CP 44/15) and the Board believes that resolution is less likely than the other outcomes while the Bank is executing its plan as accepted by the PRA and continuing to de-risk the Bank.

Despite ongoing evidence of Stability in the Core Bank franchise there is a risk that this position weakens due to currently unforeseen events.

Principal Risks – Definition

7. 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.

Why this is important and how it is managed

The longer term consequences of the macro economy from a vote to leave the EU could have a currently unquantified impact on the Bank.

The Bank continues to be subject to increased people risk. The ability to attract and retain staff remains an issue in some specialised areas. Despite improvement, employee turnover levels still remain high, reflecting the buoyancy of the external market. This increases execution risk in the Plan and reduces historical corporate knowledge.

A number of key initiatives have been undertaken during 2015 to tackle People Risk issues. The Bank's Culture Programme seeks to improve colleague engagement, reinforcing the Co-operative Bank Values and Culture, and embedding these into people policies and processes. Employee engagement levels have improved significantly throughout 2015.

A number of the Bank's executive team were recruited in 2013 to deal with the capital deficit which came to light in 2013. As the turnaround progresses, succession plans are in place to replace members of the existing team with executives to lead the Bank as it moves towards business as usual operations. The Bank is exposed to the risk that current executives may not be able to be replaced in a timely fashion with appropriate and sufficiently skilled replacements, exposing the Bank to operational disruption and potential delay in essential activities necessary for the Updated 2016-20 Plan to be successfully delivered. The Bank is similarly exposed to the risk that Non-Executive Directors may not be able to be hired for its Board as Directors serve their expected terms and stand down, particularly in the wake of increasing regulatory expectations of the Senior Manager Regime.

Given the requirements of the Capital Requirements Directive IV, which affect variable remuneration and came into force on 1 January 2016 and reflecting the Bank's non-compliance with its ICG and PRA buffer requirements until the latter part of the Updated Plan, the Bank is considering changes to its pay structures. There is a risk that any amended compensation approach could drive higher fixed costs or impact attraction and retention of staff.

Principal Risks – Definition

8. 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.

Why this is important and how it is managed

Along with the wider banking industry, the Bank must comply with multiple regulatory changes which may add complexity to an already difficult technology, operational and prudential change programme.

There is also a risk that, both foreseen and unforeseen, changes to regulatory requirements affect the Bank's ability to successfully implement its Updated Plan or that the acceptance by regulatory authorities of the Bank's plan to address the various ways in which the Bank is currently non-compliant and which is essential for the Bank to continue to operate, is withdrawn.

The regulatory position of the Bank is described at the start of this section.

As at December 2015, the Bank met its ICG, however this is a temporary position and the Bank will not sustainably meet its ICG until 2019. The PRA has accepted the Bank's plan to remediate this position. The Bank is under intense regulatory scrutiny and expects such scrutiny to continue.

The Bank is currently non-compliant with respect to certain regulatory and prudential capital requirements as described above. In summary, these areas comprise the following: being ICG non-compliant until 2019, PRA buffer non-compliance, CRR non-compliance in relation to current IRB permissions, LCR reporting requirements, FCA Threshold Conditions breach with respect to IT (non-financial resources) and insufficient embedding of the risk management framework across the Bank.

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 and the end of 2013. During this period, the PRA found that the Co-operative Bank was in breach of Principle 3 (Management and Control) with respect to the Bank's control and RMF. 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 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).

No fine was 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 then the censures would be a relevant factor in determining the outcome.

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 in to 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 or 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 result of the findings of the PRA and FCA investigations or the eventual outcome of any other investigations.

Model risk – The Bank is currently not compliant with CRR provisions related to the use of an Internal Ratings Based (IRB) approach to modelling its credit risk capital requirements. A review by the Regulator took place during 2015 and identified areas of non-compliance and inadequate procedures relating to use of an IRB approach requiring improvement and a remediation plan to rectify this, under supervisory guidance. These areas include the redesign of model risk policy and model inventory and the strengthening of the overall control and governance environment.

A failure to address model risk non–compliance would potentially result in regulatory action such that the Bank's permission to use an IRB approach could be removed, resulting in among other things the use of a standardised approach to modelling credit risk. This could expose the Bank to a material increase in the calculation of its RWAs with a consequent requirement to hold additional capital, the creation of an additional ICG deficit and a reduction in the Bank's CET1 ratio.

Money-Laundering risk – the Bank remains fully committed to supporting international and domestic efforts to combat money laundering and the funding of terrorist and criminal activity, preventing the illicit use of the Bank's products and services and to meeting the Bank's legal and regulatory obligations in full. While a remediation programme is under way, more work is required to be done in this regard.

Competition – the personal financial services industry is mature so growth often requires taking market share from competitors. The Bank faces risk of losing market share to other banks, building societies and insurance company competitors. In addition, the Competition and Markets Authority (the CMA) announced in November 2014 its decision to launch an in-depth market investigation review into the personal current account and SME retail banking sectors and this investigation is ongoing. Together with other significant retail and SME banks in the UK, the Bank is participating in the investigation which is being conducted by a Market Reference Group drawn from the CMA's panel of independent members. The CMA is scheduled to publish its final report and recommendations in July or August of 2016 and until such time the impact to the Bank and the wider industry as a whole is unknown and yet to be determined.

The financial services industry continues to be the focus of significant legislative and regulatory change which has and could continue to impose operational restrictions on the Bank, increase the Bank's costs and/or capital requirements and/or otherwise materially adversely affect its business, operating results, financial condition and prospects.

Principal Risks – Definition

9. Conduct risk

The risk that the Bank's behaviour, offerings or interactions will result in unfair outcomes for customers.

Why this is important and how it is managed

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 Regulators. 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. The 2014 decision of the UK Supreme Court in Plevin held that, judged on its own facts, non-disclosure of the amount of commission 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. The Plevin 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.

Having reassessed its exposure on available information the Bank has recognised an incremental provision of £1.3m for Plevin.

During 2015, the FCA proposed a time bar on PPI claims (which of itself could be subject to judicial challenge) and a dedicated marketing campaign to consumers as to their right to reclaim PPI. These new set of variables create challenges to accurately model future redress with certainty. As at December 2015, a provision of £87.0m (2014: £73.6m) has been recorded in respect of potential customer redress and costs relating to past sales of PPI. This includes a £71.8m charge in 2015 following a slower than expected rate of decline on inbound complaint volumes. Forecast future complaint volumes are difficult to predict and may increase, remain constant or decline more steadily due to the proposed time bar and FCA communications campaign. Accordingly, the time bar and advertising campaign may increase the overall level of claims that may be experienced by the Bank in 2016 and beyond. Additionally there may be further consumer, industry and/or legal challenges to the proposed FCA approach to Plevin or PPI more generally resulting in further uncertainty as to whether additional provisioning is required and whether this would be material for the Bank.

The Bank is continuing its programme of a structured risk based assessment of products and provisions, 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, or that changes in regulation may give rise to further conduct risks emerging.

As well as PPI, the Bank continues to monitor developments in certain product related areas, which are attracting increased focus, in some cases from both the Courts and the Financial Ombudsman Service, including loan early repayment charges, variation of certain product terms and conditions and the outcome of the judicial review of an IRHP (Interest Rate Hedging Product) loan granted by another lender and the related FCA remediation rules. Changes in the approach to any of these issues in the market could adversely affect the Bank.

Where appropriate, projects to remediate these issues are underway, these 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.

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 poor arrears handling. The Bank is addressing the recommendations from this review and has implemented enhanced policies and processes which are delivering improved customer outcomes. The outcome of the final review is uncertain but could potentially lead to enforcement investigations by the FCA.

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 accounts. 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

10. 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.

Why this is important and how it is managed

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 defined benefit section of Pace was closed to future accrual in October 2015 and the Bank is now in consultation with The Co-operative Group and the Pace Scheme Trustees with the aim of separating its liabilities in the scheme from those of other participating employers. As a consequence of the ongoing consultations, there remains uncertainty as to the quantum of any pension liabilities which may be recorded on the Bank's balance sheet in the future in relation to Pace.

The Bank is now the Principal Employer and Sponsor of the Britannia pension scheme, which is a closed defined benefit scheme. The Scheme's triennial actuarial valuation as at 5 April 2014 is still being finalised but is expected to report a deficit the quantum of which is not yet determined. There remains uncertainty as to the structure of the Bank's recovery and the period over which the Scheme's deficit will be funded, although the Bank is in consultation with respect to this. The Bank has been released from prior guarantees given in favour of the Scheme but is now Principal Employer and so is primarily liable.

Statement of Directors' responsibilities

The Directors are responsible for preparing the Annual Report and Accounts and the consolidated financial statements of The Co-operative Bank plc and its subsidiaries (the Bank) and parent company financial statements for The Co-operative Bank (the Company) in accordance with applicable law and regulations.

Company law requires the Directors to prepare Bank and Company financial statements for each financial year. Under that law they have elected to prepare the Bank and the Company financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the EU and applicable law.

Under company law the Directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Bank and Company and of their income statement for that year. In preparing each of the Bank and Company financial statements, the Directors are required to:

- select suitable accounting policies in accordance with International Accounting Standard 8: Accounting Policies, Changes in Accounting Estimates and Errors and then apply them consistently;

- present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information;

- provide additional disclosures when compliance with the specific requirements in IFRSs as adopted by the EU is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the financial performance; and

- state that the Bank and Company have complied with IFRSs as adopted by the EU, subject to any material departures disclosed and explained in the financial statements.

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

The Directors are also responsible for preparing, in accordance with applicable laws and regulations, a Strategic report, Directors' report and Corporate Governance statement that complies with that law and those regulations. The Directors are responsible for the maintenance and integrity of the corporate and financial information included on the Bank's website. Legislation in the UK governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions. The Directors consider the Annual Report and Accounts and financial statements, taken as a whole, to be fair, balanced and understandable and provide the information necessary for shareholders to assess the Bank and the Company's performance, business model and strategy.

Disclosure of information to the Auditor

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

We confirm that to the best of our knowledge:

- the financial statements, prepared in accordance with the applicable set of accounting standards, give a true and fair view of the assets, liabilities, financial position and income statement of the Company and of the undertakings included in the consolidation taken as a whole;

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

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

This responsibility statement was approved by the board of directors on 31 March 2016 and is signed on its behalf by:

Dennis Holt
Chairman
31 March 2016

The Bank income statement
For the year ended 31 December 2015
All amounts are stated in £m unless otherwise indicated

	Note	**2015**	2014 Re-presented
Interest receivable and similar income	7	**821.6**	1,064.8
Interest expense and similar charges	7	**(522.4)**	(706.8)
Net interest income		**299.2**	358.0
Fee and commission income	8	**131.9**	197.3
Fee and commission expense	8	**(60.1)**	(74.9)
Net fee and commission income		**71.8**	122.4
Other operating expense	9	**(130.3)**	(13.5)
Operating income		**240.7**	466.9
Operating expenses			
Operating expenses	10	**(765.7)**	(852.6)
Provision for customer redress	32	**(134.9)**	(52.3)
Total operating expenses		**(900.6)**	(904.9)
Operating loss before impairment losses		**(659.9)**	(438.0)
Impairment gains on loans and advances	17	**48.6**	173.2
Operating loss		**(611.3)**	(264.8)
Share of post-tax profits from joint ventures	36	**0.7**	0.6
Loss before taxation		**(610.6)**	(264.2)
Income tax	12	**(12.2)**	39.0
Loss for the financial year		**(622.8)**	(225.2)
Attributable to:			
Equity shareholders	13	**(623.3)**	(226.6)
Non-controlling interests		**0.5**	1.4
		(622.8)	(225.2)
Loss per share (basic and fully diluted)	13	**(138.05)p**	(61.48)p

The income statement has been re-presented for 2014 to reflect a change in accounting policy applied in the year regarding the re-classification of hedge ineffectiveness, gains and losses from forward contracts, options, futures, and the translation of foreign currency assets and liabilities from net trading income and net interest income to other operating expense.

The notes on pages 166 to 242 form part of these financial statements.

The Bank statement of comprehensive income
For the year ended 31 December 2015
All amounts are stated in £m unless otherwise indicated

	Equity shareholders 2015	**Non-controlling interests 2015**	**Total 2015**	Equity shareholders 2014	Non-controlling interests 2014	Total 2014
(Loss)/profit for the year	**(623.3)**	**0.5**	**(622.8)**	(226.6)	1.4	(225.2)
Other comprehensive income that may be recycled to profit and loss:						
Changes in cash flow hedges						
Net changes in fair value recognised directly in equity	**(47.6)**	**(0.1)**	**(47.7)**	43.1	(0.1)	43.0
Transfers from equity to income or expense	**26.2**	**–**	**26.2**	11.5	–	11.5
Income tax	**(3.0)**	**–**	**(3.0)**	(8.7)	–	(8.7)
Changes in available for sale assets						
Net changes in fair value recognised directly in equity	**19.1**	**–**	**19.1**	63.8	–	63.8
Transfers from equity to income or expense	**17.5**	**–**	**17.5**	(12.5)	(0.3)	(12.8)
Income tax	**(5.6)**	**–**	**(5.6)**	(12.6)	0.1	(12.5)
Other comprehensive income for the financial year, net of income tax	**6.6**	**(0.1)**	**6.5**	84.6	(0.3)	84.3
Total comprehensive income for the financial year	**(616.7)**	**0.4**	**(616.3)**	(142.0)	1.1	(140.9)

The notes on pages 166 to 242 form part of these financial statements.

The Bank balance sheet
At 31 December 2015
All amounts are stated in £m unless otherwise indicated

	Note	**2015**	2014
Assets			
Cash and balances at central banks	15	**2,678.5**	4,765.3
Loans and advances to banks	16	**871.0**	1,608.4
Loans and advances to customers	17a	**19,690.4**	25,377.4
Fair value adjustments for hedged risk	17b	**94.0**	148.5
Investment securities – loans and receivables	18a	**15.0**	18.1
Investment securities – available for sale	18b	**4,296.8**	3,167.5
Investment securities – fair value through income or expense	18c	**582.4**	1,236.9
Derivative financial instruments	19	**370.1**	470.7
Non-current assets classified as held for sale	14	**3.4**	387.3
Equity shares	20	**55.6**	2.8
Investments in joint ventures	36	**4.9**	5.3
Investment properties	22	**2.1**	2.1
Property, plant and equipment	23	**46.1**	67.5
Intangible assets	21	**142.8**	103.7
Other assets	24	**124.1**	187.6
Prepayments and accrued income	25	**43.5**	12.2
Current tax assets		**–**	0.6
Deferred tax assets	33	**7.6**	21.0
Total assets		**29,028.3**	37,582.9
Liabilities			
Deposits by banks	26	**725.9**	615.4
Customer accounts		**22,732.0**	29,614.0
Customer accounts – capital bonds	27	**77.4**	263.8
Debt securities in issue	28	**2,554.3**	3,443.6
Derivative financial instruments	19	**346.9**	551.7
Other borrowed funds	29	**459.9**	196.4
Other liabilities	30	**68.8**	157.8
Accruals and deferred income	31	**152.5**	16.0
Liabilities directly associated with non-current assets classified as held for sale	14	**–**	7.9
Provisions for liabilities and charges	32	**499.2**	617.5
Current tax liabilities		**0.3**	0.3
Deferred tax liabilities	33	**47.8**	84.0
Total liabilities		**27,665.0**	35,568.4
Capital and reserves attributable to the Bank's equity holders			
Ordinary share capital	38	**22.6**	22.6
Share premium account	38	**1,736.9**	1,736.9
Retained earnings		**(896.4)**	(273.1)
Available for sale reserve		**55.6**	24.6
Capital redemption reserve		**410.0**	410.0
Cash flow hedging reserve		**34.6**	59.0
		1,363.3	1,980.0
Non-controlling interests		**–**	34.5
Total equity		**1,363.3**	2,014.5
Total liabilities and equity		**29,028.3**	37,582.9

Approved by the Board on 31 March 2016:

Dennis Holt, Chairman
Niall Booker, Chief Executive

The notes on pages 166 to 242 form part of these financial statements.

The Bank statement of cash flows
For the year ended 31 December 2015
All amounts are stated in £m unless otherwise indicated

	2015	2014
Cash flows used in operating activities		
Loss before taxation	**(610.6)**	(264.2)
Adjustments for:		
(Increase)/decrease in prepayments and accrued income	**(31.3)**	4.3
Increase/(decrease) in accruals and deferred income	**136.5**	(38.1)
Interest payable in respect of other borrowed funds	**28.6**	22.8
Effect of exchange rate movements	**0.2**	0.5
Fair value movement on investment properties	**–**	4.5
Impairment gains on loans and advances	**(48.6)**	(170.9)
Movements on investment impairments	**–**	(20.0)
Depreciation and amortisation	**39.4**	40.0
Impairment of intangible assets	**1.3**	7.6
Interest amortisation	**6.6**	6.0
Fair value movements and amortisation of financial assets and liabilities	**(106.6)**	(206.2)
Impairment of property, plant and equipment	**–**	14.7
Gain on disposal of property, plant, equipment and software	**(3.0)**	(0.2)
Loss on disposal of investment property	**–**	1.2
Net loss on sales of subsidiaries	**0.7**	–
Unwind of fair value adjustments arising on transfer of engagements	**117.2**	97.5
	(469.6)	(500.5)
Increase/(decrease) in deposits by banks	**110.5**	(2,142.1)
Decrease in customer accounts and capital bonds	**(7,068.4)**	(3,123.6)
Decrease in debt securities in issue	**(889.3)**	(764.0)
Decrease in loans and advances to banks	**510.9**	105.3
Decrease in loans and advances to customers	**5,729.0**	5,073.6
Net movement of other assets and other liabilities	**93.5**	(236.2)
Income tax (paid)/received	**(0.1)**	4.3
Net cash flows used in operating activities	**(1,983.5)**	(1,583.2)
Cash flows from investing activities		
Purchase of tangible and intangible fixed assets	**(79.5)**	(74.9)
Proceeds from sale of property, plant and equipment	**21.4**	8.3
Proceeds from sale of investment property	**–**	156.5
Purchase of investment securities	**(1,916.3)**	(2,279.0)
Proceeds from sale and maturity of investment securities	**1,269.9**	2,580.0
Profit from sales of subsidiaries	**30.2**	–
Net cash flows from investing activities	**(674.3)**	390.9

	Note	**2015**	2014
Cash flows from financing activities			
Interest paid on other borrowed funds		**(28.6)**	(22.8)
Dividends paid to non-controlling interests		**–**	(0.2)

Issuance of other borrowed funds		**249.0**	–
Capital Commitment received from The Co-operative Group		**–**	313.0
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 from financing activities		**220.4**	677.2
Decrease in cash and cash equivalents		**(2,437.4)**	(515.1)
Cash and cash equivalents at the beginning of the financial year		**5,577.1**	6,092.2
Cash and cash equivalents at the end of the financial year		**3,139.7**	5,577.1
Cash and balances with central banks	15	**2,632.9**	4,707.5
Held for sale	14	**–**	9.1
Loans and advances to banks	16	**506.8**	745.5
Short term investments	18	**–**	115.0
		3,139.7	5,577.1

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.

The notes on pages 166 to 242 form part of these financial statements.

The Bank statement of changes in equity
For the year ended 31 December 2015
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	Total	Non-controlling interest[1]	Total equity
2015									
Balance at the beginning of the year	**22.6**	**1,736.9**	**24.6**	**59.0**	**410.0**	**(273.1)**	**1,980.0**	**34.5**	**2,014.5**
Total comprehensive (expense)/income for the year	**–**	**–**	**31.0**	**(24.4)**	**–**	**(623.3)**	**(616.7)**	**0.4**	**(616.3)**
Disposal of UTB	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**(34.9)**	**(34.9)**
Transactions with owners recorded directly in equity:									
Issuance of new share capital	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**
Dividend	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**
Balance at the end of the year	**22.6**	**1,736.9**	**55.6**	**34.6**	**410.0**	**(896.4)**	**1,363.3**	**–**	**1,363.3**
2014									
Balance at the beginning of the year	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 year	–	–	38.7	45.9	–	(226.6)	(142.0)	1.1	(140.9)
Transactions with owners recorded									

directly in equity:									
Issuance of new share capital	10.1	377.1	–	–	–	–	387.2	–	387.2
Dividend	–	–	–	–	–	(0.1)	(0.1)	(0.2)	(0.3)
Balance at the end of the year	22.6	1,736.9	24.6	59.0	410.0	(273.1)	1,980.0	34.5	2,014.5

1. In December 2015 the Bank disposed of its majority shareholding in Unity Trust Bank.

The notes on pages 166 to 242 form part of these financial statements.

Notes to the Bank financial statements
For the year ended 31 December 2015
All amounts are stated in £m unless otherwise indicated

1. Basis of preparation and significant accounting policies

1.1. Basis of preparation

Both the Company financial statements and the Bank financial statements have been prepared and approved by the Directors in accordance with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB), and as adopted by the European Union (EU).

On including the Parent Company financial statements within the Bank's Annual Report and Accounts, the Company is taking advantage of the exemption in Section 408 of the Companies Act 2006 not to present its individual income statement and related notes that form a part of these approved financial statements.

The financial statements have been prepared under the historic cost convention as modified by the revaluation of available for sale financial assets, derivative contracts, investment properties and certain other financial assets and financial liabilities held at fair value. The Bank applies the recognition, measurement and disclosure requirements of IFRS in issue that are endorsed by the EU and are effective for accounting periods beginning on or after 1 January 2015.

The financial statements comprise all audited sections of the accounts. Where indicated, the Risk Management section and capital management section form part of the audited accounts.

Standards and interpretations issued and effective

There have been no new or revised IFRS pronouncements during the year which have affected the preparation of this consolidated financial information.

Standards and interpretations issued but not yet effective

At the date of authorisation of these financial statements, the Bank has not applied the following new and revised IFRSs, that have been issued, but are not yet effective and, in some cases, not yet adopted by the EU.

- IFRS 9 (Financial Instruments)

In July 2014, the IASB issued IFRS 9 (Financial Instruments), which is the comprehensive standard to replace IAS 39 'Financial Instruments: Recognition and Measurement' and is effective for periods beginning on or after 1 January 2018, and is currently expected to be endorsed by the EU in 2016. IFRS 9 includes requirements for classification and measurement of financial assets and liabilities, impairment of financial assets and hedge accounting.

Classification and measurement

The classification and measurement of financial assets will depend on:

- how the Bank manages such assets (the entity's business model); and
- the contractual cash flow characteristics of the financial asset (whether the cash flows represent 'solely payments of principal and interest').

The above factors determine whether the financial assets are measured at amortised cost, fair value through other comprehensive income ('FVOCI') or fair value through profit or loss ('FVPL'). The application of the business model and the contractual cash flow characteristics tests may result in some differences in the population of the Bank's financial assets measured at amortised cost or fair value compared with IAS 39.

The classification and measurement of financial liabilities under IFRS 9 is not materially different to the current requirements under IAS 39, with the exception for certain liabilities measured at fair value, where gains or losses relating to changes in the entity's own credit risk are to be included in other comprehensive income as oppose to profit or loss under current rules. The Bank does not currently measure its own debt securities in issue at fair value under IAS 39 and therefore does not expect these changes to have a significant impact.

The Bank's assessment of potential classification and measurement changes to financial assets and liabilities is ongoing as part of the Bank's programme to implement IFRS 9. Given the Bank's strategy for deleverage of Non-core assets and the consequences for the business model test on the effective date of IFRS 9, it is not yet possible to set out a complete view of the expected changes to the Bank's balance sheet composition. The Bank does however anticipate that:

- Core loans and advances to banks and to customers that are classified as loans and receivables under IAS 39 will be measured at amortised cost under IFRS 9;
- financial assets designated at FVPL will remain at FVPL;
- debt securities classified as available for sale will be measured at amortised cost, FVOCI, or FVPL depending on their contractual cash flow characteristics or the business model within which they are held;
- Treasury and other eligible bills classified as available for sale will be measured at amortised cost or FVOCI depending upon the business model in which they are held; and
- there will be no significant changes to classification of financial liabilities under IFRS 9.

Impairment

IFRS 9 introduces a revised impairment model which will require entities to recognise expected credit losses based on unbiased forward-looking information, replacing the existing incurred loss model which only recognises impairment if there is objective evidence that a loss has already been incurred.

The impairment requirements of IFRS 9 apply to financial assets measured at amortised cost and FVOCI, lease receivables and certain loan commitments, and financial guarantee contracts. At initial recognition, an allowance is required for expected credit losses ('ECL') resulting from default events that are expected within the next 12 months (12-month ECL). In the event of a significant increase in credit risk, allowance (or provision) is required for ECL resulting from all expected default events over the expected life of the financial instrument ('lifetime ECL'). Financial assets where 12-month ECL is recognised are considered to be 'stage 1'; financial assets which are considered to have experienced a significant increase in credit risk are in 'stage 2'; and financial assets for which there is objective evidence of impairment so are considered to be in default or otherwise credit impaired are in 'stage 3'.

The Bank is currently defining its allowance principles under IFRS 9, determining the criteria for classification of financial assets as 'stage 1', 'stage 2' or 'stage 3'. However, IFRS 9 is expected to result in:

- a more volatile impairment charge due to the requirement of IFRS 9 to include an estimate of future conditions and not just those which existed at the balance sheet date under IAS 39; and

- an increase in the total level of impairment. This is expected as all financial assets will be assessed for impairment with reference to at least a 12 month ECL and also, the population of financial assets to which lifetime ECL applies is likely to be larger than the population for which there is objective evidence of impairment under IAS 39.

Hedge accounting

IFRS 9 contains revised requirements on hedge accounting, which are more closely aligned with an entity's risk management strategies and objectives. IFRS 9 would replace the rules under IAS 39 which require a quantitative effectiveness test with an approach which requires that an economic relationship exists between the hedged item and hedging instrument.

The Bank is considering whether to exercise the accounting policy choice to continue IAS 39 hedge accounting or move onto an IFRS 9 basis for micro hedging, but will implement the revised hedge accounting disclosures required by the related amendments to IFRS 7 'Financial Instruments: Disclosures'.

Effective date

The classification and measurement and impairment requirements are applied retrospectively by adjusting the opening balance sheet at the date of initial application, with no requirement to restate comparative periods. The mandatory application date for the standard as a whole is 1 January 2018, subject to EU endorsement.

IFRS 9 implementation programme

The Bank is assessing the impact that the financial asset and liability classification and impairment requirements will have on the financial statements and intends to quantify the potential impact of IFRS 9 once it is practicable to provide reliable estimates. Until sufficient models have been developed and tested, the Bank will not have a reliable understanding of the potential impact on its financial statements and any consequential effects on regulatory capital requirements.

The Bank plans to base the ECL calculations within impairment models on the approach used to calculate Basel expected losses (with relevant adjustments made to the Basel risk components).

- Amendment to IFRS 11 (Joint arrangements: on acquisition of an interest in a joint operation (2014))

This amendment adds new guidance on how to account for the acquisition of an interest in a joint operation that constitutes a business. The amendments specify the appropriate accounting treatment for such acquisitions.

The amendment is mandatory for years beginning on or after 1 January 2016 but is available for early adoption. The impact to the Bank of the amendment is likely to be immaterial.

- IFRS 15 (Revenue from Contracts with Customers (2014))

This standard was issued in May 2014 and is a converged standard from the IASB and FASB on revenue recognition. IFRS 15 specifies how and when an IFRS reporter will recognise revenue as well as requiring such entities to provide users of financial statements with more informative, relevant disclosures. This standard supersedes IAS 18 (Revenue) and a number of revenue interpretations.

The standard will be effective for annual reporting years beginning on or after 1 January 2018 subject to EU endorsement. The impact to the Bank of the amendments is likely to be immaterial as income from IAS 39 financial instruments is outside the scope of IFRS 15. However, the Bank has not yet finalised its estimation of the financial effects.

- Amendments to IFRS 10 (Consolidated financial statements) and IAS 28 (Investments in associates and joint ventures (2014))

These amendments address an inconsistency between the requirements in IFRS 10 and those in IAS 28 in dealing with the sale or contribution of assets between investor and its associate or joint venture. The main consequence of the amendments is that a full gain or loss is recognised when a transaction involves a business (whether it is housed in a subsidiary or not). A partial gain or loss is recognised when a transaction involves assets that do not constitute a business, even if these assets are housed in a subsidiary.

The effective date for the amendments is yet to be determined and has not yet been adopted by the EU. The impact to the Bank is likely to be immaterial.

- Amendment to IAS 16 (Property, plant and equipment) and IAS 38 (Intangible assets: on depreciation and amortisation (2014))

In this amendment the IASB has clarified that the use of revenue based methods to calculate the depreciation of an asset is not appropriate because revenue generated by an activity that includes the use of an asset generally reflects factors other than the consumption of the economic benefits embodied in the asset. The IASB has also clarified that revenue is generally presumed to be an inappropriate basis for measuring the consumption of the economic benefits embodied in an intangible asset.

The standard is mandatory for years beginning on or after 1 January 2016 but is available for early adoption. The impact to the Bank of the amendments is likely to be immaterial.

- Amendments to IAS 7 (Statement of Cash Flows)

The amendments require disclosure of information enabling users of financial statements to evaluate changes in liabilities arising from financing activities. The amendments do not define financing activities, instead they clarify that financing activities are based on the existing definition used in IAS 7.

The amendment is effective for reporting periods beginning on or after 1 January 2017 but is available for early adoption subject to EU endorsement. The impact to the Bank is likely to be immaterial.

- Amendments to IAS 27 (Separate financial statements: on the equity method (2014))

These amendments allow entities to use the equity method to account for investments in subsidiaries, joint ventures and associates in their separate financial statements.

The standard is mandatory for years beginning on or after 1 January 2016 but is available for early adoption. The impact to the Bank of the amendments is likely to be immaterial.

- Amendments to IAS 1 (Presentation of Financial Statements)

The narrow-focus amendments to IAS 1 clarify, rather than significantly change, existing IAS 1 requirements. In most cases the proposed amendments respond to overly prescriptive interpretations of the wording in IAS 1. The impact to the Bank of the amendments is likely to be immaterial.

- IAS 19 (Defined Benefit Plans (2013))

This amendment clarifies the requirements that relate to how contributions from employees or third parties that are linked to service should be attributed to periods of service. In addition, it permits a practical expedient if the amount of the contributions is independent of the number of years of service, in that contributions can, but are not required, to be recognised as a reduction in the service cost in the period in which the related service is rendered. The standard is mandatory for years beginning on or after 1 February 2015 but is available for early adoption. The amendment is not expected to have a material impact on the financial statements of the Bank.

- IFRS 16 (Leases)

The IASB has published a new standard, IFRS 16 'Leases'. The new standard brings most leases on-balance sheet for lessees under a single model, eliminating the distinction between operating and finance leases. Lessor accounting however remains largely unchanged and the distinction between operating and finance leases is retained. IFRS 16 supersedes lAS 17 'Leases' and related interpretations and is effective for periods beginning on or after 1 January 2019, with earlier adoption permitted if IFRS 15 'Revenue from Contracts with Customers' has also been applied. The impact to the Bank of the new standard has not yet been quantified.

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

The Bank intends to comply with the standards from the date they become effective.

1.2. Going Concern

a) Introduction

In line with provision C1.3 of the 2014 UK Corporate Governance Code, the Directors consider it appropriate to adopt the Going Concern basis of preparing the financial statements but note that material uncertainties exist and thus have looked to identify and disclose those material uncertainties and any other necessary disclosures to give a true and fair view. The Directors have a reasonable expectation that the Bank will continue to have the necessary resources to continue in business for the foreseeable future, taking into account the matters referred to below.

When considering the Going Concern status of the Bank, the Directors have referenced appendix A of the Financial Reporting Council's Guidance on Risk Management, Internal Control and Related Financial and Business Reporting published in September 2014, which explicitly covers the going concern basis of accounting and material uncertainties.

The assessment of the appropriateness of the Going Concern basis of accounting for the Bank's Annual Report and Accounts has been subject to a thorough process involving analysis and discussion by management, Executive and Board Committees and the Board, in line with our governance process and discussions with the Bank regulators. This analysis included a particular focus on the 12 month period following the date of publication of the financial statements.

The Directors have assessed the Going Concern status using a framework focusing on the Bank's capital, liquidity and regulatory position, as outlined in detail within the Bank's 2016-2020 Strategic Plan (the Bank's Updated Plan), which has been approved by the Bank's Board and has been accepted by the Bank's regulators.

This statement should be read in conjunction with the Viability statement on page 43 and the Principal risks and uncertainties on page 32.

b) The Updated Plan

The 2015-2019 Revised Plan was reviewed and accepted by the PRA following the stress test results (Stress Tests) announced on 16 December 2014. This plan was designed to enable the Bank to withstand a stress of the severity of the stress test by the end of the Plan period and involves reshaping and restructuring the business with a distinct focus on its Core Retail and SME operations.

Throughout 2015 a number of systemic and idiosyncratic opportunities and challenges, together with the Bank's financial performance in 2015, have driven deviations to the assumptions included within the Revised Plan accepted by the PRA. These deviations have impacted the Bank's 2015 actual performance and driven revised expectations across the planning horizon.

These include a continued low interest rate environment, improved Core Bank origination, reduced market pricing for Non-core deleverage, systemic capital market volatility, increased market wide 2015 provisions for conduct risk and further clarity around future regulatory capital requirements, including MREL.

Consequently, the Bank has undertaken a strategic review in order to assess a number of options open to management that enable the Bank to mitigate some of the impacts of these changes.

The key strategic change in the Bank's Updated Plan compared to the Revised Plan relates to the Bank ceasing any further planned deleverage of the Non-core Optimum portfolio.

The underlying resiliency of the Optimum portfolio under a severe stress scenario has improved since the 2014 Bank of England stress testing exercise. Improvements in the economic environment have led to an improvement in the underlying credit quality of the Optimum assets through reductions in average loan to value ratios and a reduction in the proportion of the book within arrears. The portfolio is now considered to be more resilient to a severe economic stress than at the time of the 2014 stress test exercise. The portfolio has also reduced significantly as a result of the two 'whole structure' securitisations undertaken in 2015 thus further reducing the overall risk impact of any deterioration in the portfolio.

Furthermore, given current market volatility the Bank believes it may not achieve similar pricing to that of the Warwick Finance One and Two transactions at this point in time, so any further deleveraging in the near term would drive unacceptably high losses on disposal. The Bank's strategy is now to continue to hold these assets, which mitigates any further losses resulting from the sale of these assets and protects the Bank's income and CET1 capital in a continued low interest rate environment. The revised strategy for the Optimum assets will continue to be reviewed in light of changing economic conditions and forecasts and to ensure the desired balance between risk and reward is maintained.

c) Capital

Total CRD IV capital resources as at 31 December 2015 are £1.6bn (31 December 2014 £1.9bn) with Core Tier 1 capital after regulatory deductions of £1.2bn (31 December 2014 £1.6bn). The Bank's CET1 ratio stands at 15.5% (31 December 2014 13.0%) on a CRD IV end point basis. During 2015 the Bank successfully issued £250.0m of Tier 2 capital, which enhanced the Bank's total capital position.

As at 31 December 2015, the Bank met the Individual Capital Guidance (ICG) for total capital set by the PRA, however it is not forecast to remain compliant against the currently in force ICG requirements for most of the duration of the 2016-2020 planning period.

The Bank is mindful of the capital implications of the Bank of England's minimum requirement for own funds and eligible liabilities ('MREL') regime and the increased debt issuance this will drive, for the banking industry in general but also for the Bank.

The Bank's Updated Plan (2016-2020) incorporates MREL qualifying issuance commencing in 2018 which is the Board's current view of the earliest time when such issuance may be feasible. The PRA and the Bank of England have indicated their strong preference that the Bank incorporates an earlier profile of MREL issuance than currently contemplated by the Bank's Updated Plan. For further details regarding MREL please refer to page 33 of the Principal risks and uncertainties.

The Bank must also seek to reduce those risks that sit outside of the Pillar 1 requirements under the ICG framework, for example, through seeking to reduce any Pillar 2a capital requirements with regards to operational risk.

The Bank continues to monitor the regulatory capital horizon for any new pieces of regulation that could impact the Bank's ability to deliver the Updated Plan. This includes, but is not limited to, any updates with regards to the implementation of the leverage ratio and MREL targets for the UK Banking sector.

The Bank is currently not compliant with CRR provisions related to the use of an Internal Ratings Based (IRB) approach to modelling its credit risk capital requirements. A review by the Regulator took place during 2015 and identified areas of non-compliance and inadequate procedures relating to use of an IRB approach requiring improvement and a remediation plan to rectify under supervisory guidance. These areas include the redesign of model risk policy and model inventory and the strengthening of the overall control environment. In March 2016 the Bank received a formal communication from the PRA regarding the levying of an additional Pillar 2a add on to cover the risks outlined above which has been factored into the Updated Plan. The Bank is in the process of creating a remediation plan in order to address the areas of non-compliance and has planned that this additional Pillar 2a add-on will be removed by the end of 2017.

A failure to address model risk non-compliance would potentially result in regulatory action such that the Bank's permission to use an IRB approach could be removed, resulting in among other things the use of a standardised approach to modelling credit risk. This could expose the Bank to a material increase in the calculation of its RWAs with a consequent requirement to hold additional capital, the creation of an additional ICG deficit and a reduction in the Bank's CET1 ratio.

Any crystallisation of proposals to implement floors for PD, LGD and CCF in retail mortgages could also impact the planned allocation of capital to such assets through the life of the plan.

The Bank remains reliant on the continued support of its regulators regarding its inability to meet regulatory capital requirements, including CRR, ICG and PRA buffer compliance.

d) Liquidity

The Bank's liquid asset ratio at 31 December 2015 was 15.4% (2014: 17.4%). 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 31 December 2015, customer assets have continued to reduce primarily as a result of the Non-core asset disposals, reducing by a total of £5.8bn. The Bank has experienced a reduction of £6.3bn 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 and the reduction in pricing on them has helped improve the margin.

The Bank redeemed the Silk Road Finance Number One securitisation in March 2015 of £1.1bn. The Warwick transactions, which completed in May and September 2015, provided £1.3bn of net funding proceeds.

The Bank expects to stay above the current and future LCR regulatory minima across the planning period.

e) Regulatory Matters

The migration of IT Infrastructure to an IBM platform (announced in January 2015) is expected, in time, to deliver proven disaster recovery capability for all critical business processes. In Q1 2015 the Bank received written confirmation from the FCA that the lack of proven end to end disaster recovery capability constituted a breach of the FCA's Threshold Conditions.

The FCA continues to closely supervise the Bank on this issue and related IT improvements, described under risks and uncertainties below, as it works towards restoring compliance with the appropriate resources (non-financial resources) Threshold Condition. The FCA is not currently proposing further immediate supervisory intervention or the immediate exercise of any additional regulatory powers as a result of this previous assessment. The assessment took place prior to the improvements that have been made during 2015. 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's Threshold Condition. However, both the PRA and FCA are closely monitoring the position of the Bank and it remains in continued dialogue with both regulators.

f) Risks and uncertainties

The key risks and uncertainties associated with the successful execution of the Bank's Updated Plan include, but are not limited to:

1. The regulators' continued acceptance of the Bank's inability to meet regulatory requirements including CRR, ICG, PRA buffer compliance and other Threshold Conditions. To the extent this acceptance is not forthcoming, the Bank does not perform in line with its Updated Plan, or regulatory capital requirements are increased for any reason, then additional CET1 or other capital may be required over and above that included in the Updated 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;

2. If in due course the Bank becomes subject to a binding requirement to issue MREL and it is unable to do so when required, the Bank's regulators can agree to accept the Bank's original issuance plan, a revised issuance plan, require some other action on the part of the Bank or in the absence of any of these the Bank of England may exercise its powers under the Banking Act 2009. In considering viability the Board has taken note of the contents of PRA consultation paper (CP 44/15) and the Board believes that resolution is less likely than the other outcomes while the Bank is executing its plan as accepted by the PRA and continuing to de-risk the Bank;

3. The Bank's IT systems have been under-invested 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, inability to deliver operating cost reductions or revenue generating capability. This would 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 transfer to the third party supplier and 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 of delay to completion, increased costs and operational disruption in the short term. However, the arrangement should help reduce risk, support increased volume and improved retention, and increase resiliency in the medium to longer term;

5. The Bank's ability to separate 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;

6. 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 increase the Bank's Pillar 2a Capital requirements or cause additional expense through increased contributions; and

7. More generally, the ability of the Bank to achieve the results set out in the Bank's Updated Plan, including further materialisation of particular challenges that are described in the Principal risks and uncertainties on pages 32 to 42 and 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 within the Corporate CoAM business; 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; ability to deliver the complex transformation plan affecting the operations and systems without significant delay and within budget, failure to achieve either of which could have negative impacts on the Bank's financial performance; major macro-economic or political upheaval such as a Brexit scenario; unplanned costs from, for example, conduct risk matters, regulatory investigations, unforeseen regulatory change, IT investment and the ability to maintain the Bank's access at, an appropriate cost, to liquidity and funding.

g) Conclusion

The Directors have concluded that the risks outlined above 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. The Bank remains reliant on the continued support of its regulators regarding its inability to meet capital regulatory requirements (CRR), including ICG and PRA buffer compliance, during and beyond the period of the Going Concern assessment.

Nevertheless, after making enquiries of management and considering the Bank's Updated Plan, in particular those for the twelve month period following the date of the Bank's financial statements, the Directors have a reasonable expectation that the Bank will have adequate resources to continue in business over this period. For these reasons they continue to adopt the Going Concern basis in preparing these financial statements. Therefore this set of financial statements does not include the adjustments that would result if the Bank was unable to continue as a Going Concern.

1.3. Significant accounting policies

The accounting policies set out below have been applied consistently to all periods, inclusive of assets recognised where the Bank is subject to the substantial risks and rewards of those assets.

1. Business combinations

On 1 August 2009, The Co-operative Bank plc merged with Britannia Building Society, with Britannia transferring their engagements to the Bank. This business combination has been accounted for by applying the requirements of IFRS 3 (Business Combinations (2004)).

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

2. Basis of consolidation

a) Subsidiaries

Subsidiaries are all entities (including structured entities) controlled by the Company. Control exists whenever the Company is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity, in accordance with the requirements of IFRS 10 (Consolidated financial statements). In assessing control, potential voting rights that presently are exercisable are taken into account. The financial information of subsidiaries is included in the consolidated financial information from the date that control commences until the date that control ceases.

When the Company ceases to have control any retained interest in the entity is re-measured to its fair value at the date control is lost, with the change in carrying amount recognised in the profit or loss. The fair value is the initial carrying amount for the purposes of subsequently accounting for retained interest as a financial asset. In addition, any amounts previously recognised in other comprehensive income in respect of that entity are accounted for as if the Group had directly disposed of the related assets or liabilities. This may mean that amounts previously recognised in other comprehensive income are reclassified to profit or loss.

The financial information has been prepared using uniform accounting policies and is based on the same accounting period as the Company.

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

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

- various securitisation transactions in which mortgages were sold to SPEs. The equity of these SPEs is not owned by the Company; and
- Covered Bond Limited Liability Partnership created in order to act as a guarantor for the issue of covered bonds.

An SPE is consolidated if, based on an evaluation of the substance of its relationship with the Bank under IFRS 10 considerations, the Company concludes that it controls the SPE.

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

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

The assessment of whether the Company has control over an SPE is carried out at inception. A reassessment of whether the Company has control over an SPE is performed at the end of each period.

b) Interests in joint ventures

A joint venture is a joint arrangement whereby the parties that have joint control of the arrangement, have rights to the net assets of the arrangement.

Those parties are called joint venturers. The Bank's interests in joint ventures are accounted for using the equity method. The consolidated financial information includes the Bank's share of the income and expenses and equity movements of equity accounted investees, after adjustments to align the accounting policies with those of the Bank.

c) Interests in unconsolidated structured entities

Unconsolidated structured entities are unconsolidated entities that have been designed so that voting or similar rights are not the dominant factor in deciding who controls the entity. The Bank does not consolidate structured entities where the Bank determines, with due regard to the variable returns from the structured entity and the Bank's ability to affect those returns, that it does not control the structured entity under IFRS 10 (Consolidated financial statements) considerations. The Bank acts as a sponsor for certain unconsolidated securitisation vehicle holding companies which the Bank neither owns nor controls. The Bank has determined itself a sponsor of unconsolidated securitisation vehicle companies if the Bank does not have a material ongoing interest in the entity, but it may act to protect its reputation in relation to the structured entity.

3. Revenue recognition

a) Interest income and expense

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

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

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

When an instrument is impaired, the Bank reduces the carrying amount, based on the revised cash flows, discounted at the original EIR of the instrument, and continues unwinding the discount as interest income.

Early redemption charges are recognised on a cash basis as received, as it is not possible to reliably estimate the receipt of such fees.

b) Fees and commissions

Fee and commission income is predominantly made up of arrangement and other fees relating to loans and advances to customers that are included in the EIR calculation.

Commitment fees received are deferred and included in the EIR calculation upon completion or taken in full at the date the commitment period expires and completion does not occur.

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

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

4. Financial instruments (excluding derivatives)

a) Recognition

Financial assets are recognised in the Bank's balance sheet when the Bank becomes party to the contractual provisions of the instrument. The Bank initially recognises loans and advances when they are advanced to customers. Deposits, debt securities issued and other borrowed funds are recognised on the date at which they are originated. Regular way purchases and sales of financial assets are recognised on the trade date at which the Bank commits to purchase or sell the asset.

b) Derecognition

The Bank derecognises a financial asset when the contractual rights to the cash flows from the financial assets expire, or it transfers the rights to receive the contractual cash flows in a transaction in which substantially all of the risks and rewards of ownership of the financial asset are transferred. If the Bank neither transfers nor retains substantially all the risks and rewards of ownership and continues to control the transferred asset, the Bank recognises its retained interest in the asset and an associated liability for amounts it may have to pay. A substantial modification of the terms of an existing financial liability or a part of it (whether or not attributable to the financial difficulty of the debtor) is accounted for as an extinguishment of the original financial liability and a recognition of a new financial liability.

When a financial asset is derecognised in its entirety, the difference between the carrying amount and the sum of the consideration received (including any new asset obtained less any new liability assumed), and any cumulative gain or loss that had been recognised in other comprehensive income, is recognised in the income statement.

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

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

c) Financial assets

i. Overview

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

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

ii. Loans and receivables

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

Loans and receivables mainly comprise loans and advances to banks and customers (except where the Bank has elected to carry the loans and advances to customers at fair value through income or expense as described in accounting policy (4.c) iv. below).

The Bank has a number of facility agreements with multiple counterparties, which form a single contractual relationship. The Bank considers these arrangements to be single financial instruments and accounts for these accordingly within loans and advances to customers, or customer deposits respectively.

iii. Available for sale

Available for sale financial assets are debt securities and equity shares quoted in an active market and not accounted for at fair value through profit or loss. These are initially recognised on their trade date, measured at fair value based on current bid prices where quoted in an active market. Where the debt securities and equity shares are unlisted the fair values are based on valuation techniques including discounted cash flow analysis, with reference to relevant market rates, and other commonly used valuation techniques. Movements in fair value are recorded in equity as they occur. On disposal, gains and losses recognised previously in equity are transferred to the income statement. In exceptional circumstances, for instance where the market in the securities has become inactive, these are reclassified as loans and receivables.

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

iv. Financial assets at fair value through profit or loss

Financial assets designated at fair value are assets which have been designated to eliminate or significantly reduce a measurement inconsistency or where management specifically manages an asset or liability on that basis, e.g. capital bonds.

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

d) Financial liabilities

i. Overview

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

Financial liabilities, other than derivatives and capital bonds, are subsequently measured at amortised cost. Derivative financial liabilities are subsequently re-measured to their fair value at each balance sheet date. The resulting gain or loss is recognised in the income statement immediately unless the derivative is designated and effective as a hedging instrument in a cash flow hedge. See 'Derivative financial instruments and hedge accounting' policy for more detail.

Capital bonds within customer accounts have been designated at fair value through profit or loss upon initial recognition in the balance sheet. Changes in fair value are recognised through the income statement.

Capital bonds are economically hedged using equity linked derivatives, which do not meet the requirements for hedge accounting. Recording changes in fair value of both the derivatives and the related liabilities through the income statement most closely reflects the economic reality of the transactions, eliminating potential measurement inconsistency that would otherwise arise from valuing the capital bonds at amortised cost and the derivatives at fair value.

When a financial liability is derecognised any cumulative gain or loss that had been recognised in other comprehensive income, is recognised in the income statement.

ii. Other borrowed funds

Borrowings are recognised initially at fair value, being issue proceeds net of transaction costs incurred. Borrowings are subsequently stated at amortised cost; any difference between proceeds (net of transaction costs) and the redemption value is recognised in the income statement over the estimated life of the liability using the EIR method.

The Bank classifies capital instruments as financial liabilities or equity instruments in accordance with the substance of the contractual terms of the instruments.

5. Impairment provisions

a) Assessment

i. Objective evidence

At the balance sheet date, the Bank assesses whether there is objective evidence that a financial asset or group of financial assets, not held at FVPL, is impaired. Impairment losses are incurred only if there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition and before the statement of financial position date (a 'loss event') which has an impact on the estimated future cash flows of the financial asset that can be reliably estimated.

Objective evidence that financial assets are impaired can include significant financial difficulty of the borrower, a breach of contract, such as default or delinquency in interest or principal payments, the granting by the Bank to the borrower, for economic and legal reasons relating to the borrower's financial difficulty, a concession that the Bank would not otherwise consider, indications that a borrower or issuer will enter bankruptcy or other financial reorganisation, or the disappearance of an active market for a security.

The Bank considers evidence for impairment for loans and advances at both a specific asset and collective level.

ii. Forbearance

The Bank operates a policy of forbearance which mitigates against borrower default. All such cases are included within its provisioning methodology.

Residential secured mortgages

Loans under forbearance are subject to a specific identified impairment assessment.

Unsecured Retail business

Irrespective of forbearance, impairment is charged in accordance with the identified past due and unidentified loss event approaches described on page 114.

Corporate business

All accounts subject to forbearance which are in default and on the watchlist are individually assessed for impairment.

For further information on the Bank's approach to forbearance, its management and execution, see the Risk Management section.

b) Scope

i. Individual accounts

All secured loans and advances are assessed for impairment using a range of criteria graded for levels of risk. Accounts at risk of impairment are monitored and impaired where they display clear indicators of underperformance.

All Corporate loans on watchlist, or in default, are individually assessed for impairment.

Loans and advances that do not meet the criteria for individual impairment, or which do, but are not found to be impaired, are collectively assessed for impairment (incurred but not yet reported) by grouping together loans and advances of similar risk characteristics.

ii. Collective accounts

a) Retail

When assessing collective impairment for secured retail loans, the Bank estimates a shortfall based on the difference between the current loan balance and the expected 'forced sale' price of collateral, discounted at the effective interest rate of the loan to reflect the anticipated time to sale, and taking into account anticipated fees and costs prior to sale. The shortfall is multiplied by the probability the loan will default and further multiplied by the probability that the loan will be taken into possession to determine the impairment required.

When assessing collective impairment for unsecured retail loans, the Bank estimates losses on loans via a two stage approach, which determines PD and LGD to generate provision rates which are applied to the current balance sheet, including loans transferred to debt collection agencies. Once impaired, accounts are subjected to higher levels of impairment according to both their relevant stage of delinquency, i.e. the number of days in arrears, and their consequent likelihood of ultimately being charged off. Default rates, loss rates and future recoveries are regularly benchmarked against actual outcomes to ensure that they remain appropriate.

Impairment stock determined by provision models is augmented where it is judged that the best estimate of losses are likely to differ from those suggested by historical trends. Impairment determined both via provision models and management overlays are reviewed by the Impairment Adequacy Forum.

b) Corporate

Collective provision is held for all Corporate exposures, apart from customers in default for which specific provision has been raised and customers in default with nil impairment for which there is evidence that they have been individually assessed at SAR. Collective provision is determined by multiplying the drawn balance of the loan by the following default estimates:

i) the probability that, during the emergence period, balances will move to default; or
ii) the probability that, during the emergence period, balances will move to impaired; and
iii) the probability that, during the outcome period, balances will move from impaired to default

The resulting balance is multiplied by the proportion of newly defaulted balances that ultimately move to an unrecoverable LGD.

The loss emergence period is defined as the time between a loss event occurring and it being evidenced. For Corporate loans the emergence period is 6 months and is reviewed annually. For all commercial real estate loans where the indexed loan-to-value LTV is greater than 100% and to those loans which are due to contractually expire in the next 36 months and the indexed LTV is greater than 65% the probability of emerging to impaired Pe(i) parameter is set to 100%. All other PD components are based on recently observed loan migration experience. Loans which are on watchlist are impaired and therefore Pe(i) is set to 100%.

c) Measurement

The amount of the loss is the difference between:

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

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

d) Impairment of financial assets carried at amortised cost

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

A write off is made when all or part of a claim is deemed uncollectable or forgiven after all the possible collection procedures have been completed and the amount of loss has been determined. Write offs are charged against previously established provisions for impairment or directly to the income statement.

Any additional recoveries from borrowers, counterparties or other third parties made in future periods are offset against the write off charge in the income statement once they are received.

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

e) Impairment of financial assets classified as available for sale

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

When a subsequent event causes the amount of impaired loss on available for sale investment securities to decrease, and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed through the income statement.

However, any further recovery in the fair value of an impaired available for sale equity security is recognised directly in equity.

6. Sale and repurchase agreements

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

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

7. Derivative financial instruments and hedge accounting

a) Derivatives used for asset and liability management purposes

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

Derivative financial instruments are stated at fair value based on quoted market prices in active markets and, where these are not available, using valuation techniques such as discounted cash flow models. Further information is provided in note 19. All derivatives are carried as assets when the fair value is positive and liabilities when the fair value is negative. The gain or loss on re-measurement to fair value is recognised immediately in the income statement except where derivatives qualify for cash flow hedge accounting.

Where hedge accounting is applied, the Bank formally documents the economic relationship between the hedging instrument(s) and hedged item(s) including the risk management objective and strategy in undertaking the hedge transaction together with the method used to assess effectiveness of the hedging relationship.

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

i. Cash flow hedges

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

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

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

ii. Fair value hedges

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

Fair values are based on quoted market prices in active markets or, where these are not available, using valuation techniques such as discounted cash flow models. If the derivative expires or is sold, terminated, or exercised, or no longer meets the criteria for fair value hedge accounting, or the designation is revoked, then hedge accounting is prospectively discontinued. Any adjustment up to that point, to a hedged item for which the EIR method is used, is amortised to income or expense as part of the recalculated EIR of the item over its remaining life.

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

As part of its risk management process the Bank identifies portfolios whose interest rate risk it wishes to hedge. The portfolios may comprise only assets, only liabilities or both assets and liabilities. The Bank analyses each portfolio into repricing time periods based on expected repricing dates, by scheduling cash flows into the periods in which they are expected to occur. Using this analysis, the Bank decides the percentage it wishes to hedge and designates as the hedged item an amount of assets or liabilities from each portfolio equal to this. The Bank measures monthly the change in fair value of the portfolio relating to the risk that is being hedged. Provided that the hedge has been highly effective, the Bank recognises the change in fair value for the hedged risk of each hedged item in the income statement with the cumulative movement in its value being shown on the balance sheet as a separate item, fair value adjustment for hedged risk, either within assets or liabilities as appropriate. If the hedge no longer meets the criteria for hedge accounting, this amount is amortised to the income statement over the remaining average useful life of the hedge item on an appropriate basis.

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

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

b) Embedded derivatives

A derivative may be embedded in another instrument, known as the host contract. Where the economic characteristics and risks of an embedded derivative are not closely related to those of the host contract (and the host contract is not carried at fair value through profit or loss), the embedded derivative is separated from the host and held on-balance sheet at fair value. Movements in fair value are recognised in the income statement, whilst the host contract is accounted for according to the relevant accounting policy for that particular asset or liability.

8. Property, plant and equipment

The Bank recognises assets where it is exposed substantially to all the risks and rewards of those assets.

Acquired computer software licences are capitalised on the basis of cost incurred to acquire and bring the software to use.

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

Long leasehold land and buildings	40–50 years
Freehold and leasehold improvements	10–40 years
Short leasehold buildings	life of lease
Equipment:	
Computer	3–7 years
Furniture and equipment	3–10 years

All items of property, plant and equipment are reviewed for indications of impairment on a regular basis and at each balance sheet date. If impairment is indicated, the asset's recoverable amount (being the greater of fair value less cost to sell and value in use) is estimated. Value in use is calculated by discounting the future cash flows generated from the continuing use of the asset.

If the carrying value of the asset is greater than the recoverable amount, the shortfall is recognised in the income statement.

Gains and losses on disposal of an item of property, plant and equipment are determined by comparing the proceeds from disposal, less costs to sell, with the carrying amount and are recognised net within operating expenses in the income statement.

9. Intangible assets

The Bank recognises intangible assets where it is exposed substantially to all the risks and rewards of those assets.

a) Computer software

Computer software is stated at cost less cumulative amortisation and impairment, and comprises acquired computer software together with the costs of internal development of the software.

Acquired computer software licences are capitalised on the basis of cost incurred to acquire and bring the software to use.

Costs that are directly associated with the internal production of software products that will generate future economic benefit are capitalised. Only costs which meet the definition of development costs under IAS 38

(Intangible Assets) are capitalised. Costs are capitalised only if the asset can be reliably measured, will generate future economic benefits, the completion of the asset is feasible, there is an intention to complete the asset, an intention and ability to use the asset, and costs attributable to the asset are able to be reliably measured. Expenditure that is not directly attributable to the development of such assets is recognised in the income statement in the period to which it relates.

The expenditure capitalised includes direct employee costs and an appropriate portion of relevant direct overheads. Once the asset is available for use amortisation is charged to the income statement on a straight line basis to allocate the cost over the estimated useful life up to a maximum of seven years.

b) Other intangible assets

Other intangible assets are stated at cost less cumulative amortisation and impairment. Amortisation is charged on a straight line basis over the useful life of the asset. For core systems, a review of the asset’s useful life is carried out and a maximum useful life of up to 10 years is applied.

c) Impairment

Intangible assets are assessed for indications of impairment at least annually. If impairment indicators are discovered, the asset’s recoverable amount (being the greater of fair value less cost to sell and value in use) is estimated. Value in use is calculated by discounting the future cash flows generated from the continuing use of the asset. If the carrying value of the asset is less than the greater of the value in use and the fair value less costs to sell, the shortfall is recognised as a charge to the income statement. Irrespective of whether there is any indication of impairment, intangible assets in the course of construction are tested for impairment at least annually.

10. Goodwill

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

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

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

11. Leases

a) Overview

The Bank enters into leases for land and buildings, finance leases for software and operating leases for vehicles and equipment.

Leases for land and buildings are split between leases for the land and leases for the buildings for accounting purposes only. The leases are separately assessed as to whether they are finance or operating leases. The Bank’s policy is to provide for the minimum future lease payments on buildings that it does not currently use, net of expected rental income from sub-leases. The Bank provides for dilapidation where an obligation exists to make good dilapidation or other damage, or return the asset to the configuration that existed at the inception of the lease.

b) Assets leased to customers

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

c) Assets leased from third parties

i. Finance leases

The amount to be recognised as a finance lease is calculated on inception of the lease. Finance lease assets are capitalised at commencement of the lease (being the date at which the Bank is able to exercise its right to use the asset) at the lower of fair value of the leased asset and the present value of the minimum future lease payments, and subsequently in accordance with the relevant policy for the underlying asset. An equal liability is recorded in other liabilities. The interest element of the finance charge is allocated to the lease payments so as to record a constant periodic rate of charge on the outstanding liability.

ii. Operating leases

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

12. Investment property

Property held for long term rental yields, that is not occupied by the Bank or property held for capital appreciation, is classified as investment property. Investment property comprises freehold land and buildings. The Bank accounts for all investment properties using the fair value method. Fair value is based on current prices in an active market for similar properties in the same location and condition. No depreciation is provided on investment properties. Any gain or loss arising from a change in fair value is recognised in the income statement.

If the Bank takes occupancy of an investment property, it is reclassified as property, plant and equipment and its fair value at the date of reclassification becomes its cost for subsequent accounting purposes. Prior to such a transfer the property is measured at fair value with any gain or loss recognised in the income statement. Similarly, transfers to the investment property portfolio are made when occupancy by the Bank ceases and the property meets the criteria of an investment property under IAS 40.

13. Cash and cash equivalents

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

Overdrafts that are repayable on demand and form an integral part of the Bank’s cash management are included as a component of cash and cash equivalents for the purpose of the cash flow statement.

14. Income tax

a) Overview

Tax for the year comprises current and deferred tax, which is recognised in the income statement except to the extent that it relates to items recognised directly in equity, in which case it is recognised in the statement of comprehensive income. In addition, estimated amounts receivable from TCG for tax losses surrendered and changes in that estimate are recorded as an adjustment to the tax expense.

b) Current tax

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

c) Deferred tax

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

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

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

15. Pension costs

a) Co-operative Pension Scheme

The Bank participates in the Co-operative Pension Scheme (Pace). Pace is a hybrid scheme, consisting of a closed defined benefit section and a defined contribution section. There is currently insufficient information available to consistently and reliably identify the Bank's share of its liabilities in respect of this multi-employer scheme. For this reason the pension costs in respect of Pace are accounted for on a defined contribution basis in accordance with IAS 19 Employee Benefits (revised 2011). Pension costs are recognised as an expense in the Bank's income statement. See note 34 for further details.

b) Britannia Pension Scheme

The Britannia scheme is a defined benefit scheme. On the 23 December 2015, a Flexible Apportionment Arrangement (FAA) was executed, at which time the Co-operative Bank plc was named as a participating employer and replaced CFSMS as the principal employer, following which, CFSMS, WMS and PHL departed from the scheme with their share of the scheme's liabilities being transferred to the Bank. As the Bank had already been recognising the total assets and liabilities of the scheme on its balance sheet, due to a guarantee it provided, the FAA has not had a significant new impact on the Bank's exposure to the risks of the scheme. See note 34 for further details.

Accordingly, the Bank recognises the fair value of the scheme assets less the present value of the scheme's estimated obligations, less an asset restriction that reflects the Bank's inability to access the surplus in the scheme. In addition, the Bank recognises as a liability the present value of irrecoverable minimum funding requirements. The defined benefit obligation is calculated annually by independent actuaries using the projected unit credit method. The present value of the defined benefit obligation is determined by discounting the estimated future cash outflows using interest rates on high quality corporate bonds.

Actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions are charged or credited to equity in other comprehensive income in the period in which they arise. Past service costs are recognised immediately in income.

When the scheme is in an accounting surplus, this is not recognised as an asset in accordance with IFRIC 14. Actuarial gains are only recognised to the point where any previously recognised liability is reversed.

16. Foreign currency

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

17. Investments in Co-operative Bank undertakings

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

18. Provisions for liabilities and charges

A provision is recognised in the balance sheet if the Bank has a legal or constructive obligation as a result of a past event and it is probable that an outflow of economic benefits will be required to settle the obligation. If the effect is material, provisions are determined by discounting the expected future cash flows at an appropriate pre-tax rate, if the expected future cash flows can be reliably estimated.

In the case of restructuring provisions, a constructive obligation arises when a plan is sufficiently detailed and is formalised. Restructuring provisions include only direct expenditure arising from the restructuring plan which is both necessary for restructuring and not associated with the Bank’s ongoing activities.

Provisions are recognised for discounts on performing loans identified for disposal at the balance sheet date which will be sold post year end at a loss.

19. Share premium

Share premium is the amount by which the fair value of the consideration received exceeds the nominal value of shares issued. Expenses and commissions paid on the issue of shares are written off against the share premium of the same issue.

20. Assets held for sale

Non-current assets and disposal groups (including both the assets and liabilities of the disposal groups) are classified as held for sale when their carrying amounts will be recovered principally through sale, they are available for sale in their present condition and their sale is highly probable. Non-current assets held for sale and disposal groups are measured at the lower of their carrying amount and fair value less cost to sell, except for those assets and liabilities that are not within the scope of the measurement requirements of IFRS 5 (Non-current Assets Held for Sale and Discontinued Operations) such as deferred taxes, financial instruments, investment properties, insurance contracts and assets and liabilities arising from employee benefits. These are measured in accordance with the accounting policies described above. Immediately before the initial classification as held for sale, the carrying amounts of the asset (or assets and liabilities in the disposal group) are measured in accordance with applicable IFRSs. On subsequent remeasurement of a disposal group, the carrying amounts of the assets and liabilities noted above that are not within the scope of the measurement requirements of IFRS 5 are remeasured in accordance with applicable IFRSs before the fair value less costs to sell of the disposal group is determined.

21. Share-based payments

For cash settled share-based payments, a liability is recognised for the goods or services acquired, measured initially at the fair value of the liability at the grant date. The fair value excludes the effect of non-market based vesting conditions. At each balance sheet date until the liability is settled, and at the date of settlement, the fair value of the liability is re-measured, with any changes in fair value recognised in the profit or loss for the year. Details regarding the determination of the fair value of cash settled share-based transactions are set out in note 40.

Cash settled share-based payments are expensed on a straight line basis over the vesting period, based on the Bank's estimate of awards that will eventually vest, and adjusted each year for the change in fair value. The vesting period is the period over which all specified vesting conditions are to be satisfied. At each balance sheet date, the Bank revises its estimate of the number of awards expected to vest as a result of the effect of non-market based vesting conditions. The impact of the revision of the original estimates, if any, is recognised in the profit or loss such that the cumulative expense reflects the revised estimate, with a corresponding adjustment to the liability.

2. Critical judgements and estimates

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

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

The judgements and assumptions that are considered to be the most important to the portrayal of the Bank's financial condition are those relating to loan impairment provisions, conduct risk and legal provisions, deferred tax, pensions, separation provision, effective interest rates (EIR) and fair value adjustments, group relief receivable and derecognition of financial assets.

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 individually impaired 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 £101.5m (2014: £107.3m). 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 PD and 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 has been used for each category of arrears and for each product, this would increase the collective provision by £5.5m for all of the unsecured portfolios.

A key estimate used in the secured impairment model provisioning is the collateral value. A 10% decrease in the indexed collateral used in the model would increase the provision by £1.2m.

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 £7.5m (2014: £16.7m).

The collective provision is calculated using factors such as observed default rates and LGD. As 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 PDs.

There were no significant changes to the collective provision methodology in 2015 except for i) utilising property collateral for non-CRE customers when assessing their loss rates, and ii) the introduction of explicit discounting in assessing the proceeds of property sales.

The strategic deleveraging of the Bank's Non-core assets in 2015 has been the primary reason for the reduction in the collective provision.

The impact of increasing the default rates by 10% is an increase of the collective by £1.1m. A 10% decrease in collateral values would increase the provision by £1.6m.

ii) Optimum collective

In addition to the above, collective provisions of £3.3m (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 £7.0m.

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

Further explanation of collection loan impairment method 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 £3.8m (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 £118.4m (2014: £386.8m). The provision has decreased reflecting improving macroeconomic factors and the Bank's strategic deleverage 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.

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 £9.9m. (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.

b. Conduct risk and legal provisions

i. Overview

The conduct and legal risks provision involves significant judgement and therefore constitutes one of the Bank's critical accounting estimates.

Significant components of the conduct risk and legal provision are potential customer redress in relation to Payment Protection Insurance (PPI), and breaches of the technical requirements of the Consumer Credit Act (CCA). The Bank has also made provision for conduct issues requiring redress which are individually less significant.

The calculation of these conduct and legal provisions requires significant judgement by management in determining appropriate assumptions. Key assumptions include the basis of redress, operating costs of resolving redress, the level of complaints, Bank uphold rates, and the Financial Ombudsman Service referral and uphold rates.

ii. Payment Protection Insurance (PPI)

A provision of £87.0m (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, bringing the total provisions raised to date of £423.8m (2014: £352.0m).

The most significant factors behind the £71.8m increase are the rate of decline of the inbound complaint volumes was slower than previously expected and forecast future inbound complaint volumes are expected to remain higher than originally forecast due to the proposed time bar by which customers can bring a claim and the associated FCA communications campaign. The increased forecast volume of complaints has led to an increase in operational delivery costs.

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, and 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	92,000	23,000	1,000 = £2.6m
Average uphold rate per valid[1] complaint	65%	69%	1% = £0.5m
Average redress per upheld complaint	£3,339	£2,774	£100 = £0.7m

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.

iii. Breaches of the technical requirements of the Consumer Credit Act (legal provision) – Unsecured Loans

An amount of £124.8m (2014: £162.1m) has been provided regarding interest refunds following identification of breaches of the technical requirements of the CCA. The Bank's redress and remediation programme is ongoing but is expected to be completed in 2016. Once the Bank remediates open loan accounts they become compliant with the CCA and the Bank can start to recognise loan interest again.

The increase in the gross provision reflects further interest chargeable on affected loans in accordance with relevant loan agreements which requires redressing, an updated estimate of the costs which will be incurred in delivering redress, and an increase in the provision because of a change to assumptions reflecting the latest actual redress amounts. The provision will continue to increase in line with interest charged until the issue is resolved.

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 December 2015.

Included within the provision are operating costs of £20.0m based upon the latest view of delivery timeframes.

iv. Other conduct/compliance related provisions

Other conduct/compliance related provisions include the following:

- £5.9m (2014: £17.8m) for potential customer redress relating to the processing of first payments on certain mortgages;
- £27.3m (2014: £24.0m) relating to potential customer redress in relation to mortgage early redemption charges;
- £4.7m (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);
- £6.5m (2014: £20.0m) relating to potential customer redress due to mortgage customer detriment;
- £9.4m (2014: £34.8m) for potential customer redress in relation to arrears fees and charges;
- £27.9m (2014: £17.4m) relating to packaged accounts;
- £15.0m (2014: £15.0m) relating to provision for potential conduct issues incurred but not identified;
- £1.2m (2014: £7.0m) relating to potential customer redress and other costs in relation to mortgage documentation;
- £21.9m (2014: £22.5m) relating to cost of mortgage redress;
- £3.6m (2014: £14.8m) relating to interest rate swaps; and
- £20.3m (2014: £12.2m) of other conduct provisions.

Key assumptions include basis of redress, operating costs of resolving redress, the level of complaints, uphold rates, proactive contact and response rates and Financial Ombudsman Service referral and uphold rates.

c. Deferred tax

The Bank has recognised a deferred tax asset of £7.6m (2014: £21.9m) which includes £nil (2014: £0.9m) within a disposal group classified as held for sale.

The Bank has recognised a deferred tax liability of £47.8m (2014: £84.0m).

The deferred tax asset relates to temporary differences 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 trading losses or other temporary differences as doubt exists over the availability of sufficient future taxable profits.

During the year, effective from 1 April 2015, the standard rate of corporation tax in the UK changed from 21% to 20%. Reductions in the UK corporation tax rate from 20% to 19% (effective from 1 April 2017) and 18% (effective from 1 April 2020) were substantively enacted on 18 November 2015. A banking surcharge tax of 8% will also apply to the Bank (effective from 1 January 2016) and this change was substantively enacted on 18 November 2015. Deferred tax has been calculated by reference to the most appropriate rate based on forecasts.

d. Pensions

i. Defined contribution accounting for the Pace scheme

The Bank participates in Pace. Pace is a hybrid scheme, consisting of a closed defined benefit section and a defined contribution section. There is currently insufficient information available to consistently and reliably identify the Bank's share of its liabilities in respect of this multi-employer scheme. For this reason 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 £2.5m (2014: £2.9m) has been recognised in relation to the annual deficit funding which the Bank has agreed to pay. 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 34 for further details.

ii. Defined benefit accounting for the Britannia scheme

The Britannia scheme is a defined benefit scheme. On the 23 December 2015, a Flexible Apportionment Arrangement (FAA) was executed, at which time the Co-operative Bank plc was named as a participating employer and replaced CFSMS as the principal employer, following which, CFSMS, WMS and PHL departed from the scheme with their share of the scheme's liabilities being transferred to the Bank. As Bank had already been recognising the total assets and liabilities of the scheme on its balance sheet, due to a guarantee it provided, the FAA has not had a significant impact on the Bank's exposure to the risks of the scheme. See note 34 for further details.

The next full (triennial) actuarial funding valuation of the Britannia Pension Scheme, with an effective date of 5 April 2014, is currently ongoing. Consequently it is considered there was no minimum funding requirement at the year end.

Further information on the financial implications of accounting for the Britannia scheme on a defined benefit basis is disclosed in note 34.

iii. Sensitivity of defined benefit obligations

The measurement of the Bank's defined benefit liability is particularly sensitive to changes in certain key assumptions, which are described below. The methods used to carry out the sensitivity analyses presented below for the material assumptions are the same as those the Bank has used previously. The calculations alter the relevant assumption by the amount specified, whilst assuming that all other variables remained the same. This approach is not necessarily realistic, since some assumptions are related; for example, if the scenario is to show the effect if inflation is higher than expected, it might be reasonable to expect that nominal yields on corporate bonds will increase also. However, it enables the reader to isolate one effect from another.

e. Separation provision

During November 2013, the Bank publically announced its intention to separate from The Co-operative Group. The Bank has recognised a provision of £64.3m (2014: £112.3m) in relation to separation costs which are eligible to be provided for under IAS 37 (Provisions, Contingent Liabilities and Contingent Assets). For further details please refer to note 32.

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. A reasonably possible change in overall estimates of costs for key separation provision judgements could increase the provision by £8.0m.

f. 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 after the expiry of the fixed rate period for all products would result in an £8.6m (26%) increase in the EIR adjustment required to the loans and advances to customers balance as at 31 December 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 assumed call date, the Leek notes fair value adjustment would decrease by £17.1m (7.2%) as at 31 December 2015, resulting in additional expense of £17.1m in the year to 31 December 2015.

g. Group relief receivable

As part of the negotiations relating to the separation of the Bank from The Co-operative Group, the Bank and The Co-operative Group agreed terms relating to the surrender of group relief between the entities in the Bank's tax group and entities in The Co-operative Group tax group. A deed sets out the basis of the agreement by The Co-operative Group to take proactive steps to allow it to maximise its claim for tax losses from the Bank for the accounting periods to 31 December 2012 and 2013. The deed also addresses the terms of the payment by The Co-operative Group to the Bank for those tax losses. The 2015 financial statements, which include a group relief receivable of £60.1m (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. The value of the asset is sensitive to a number of assumptions including the forecast repayments provided by The Co-operative Group for the periods to 2018; The Co-operative Group's capital expenditure qualifying for capital allowances in future periods; The Co-operative Group's taxable profits in future periods; the Bank's extrapolation of the forecast repayments for the periods after 2018; the rate of corporation tax; the rates at which capital allowances on qualifying capital expenditure are available; and The Co-operative Group's capacity to claim the tax losses. If The Co-operative Group's capacity to realise benefit in 2018 from the previously surrendered losses decreases by 5%, the value of the group relief receivable decreases by £5.1m.

h. Derecognition of financial assets

During the year, the Bank closed two whole structure securitisations of its Non-core optimum residential mortgage portfolio through the issuance of notes and residual certificates by Warwick Finance 1 and Warwick Finance 2. Those assets were assessed for derecognition on a stand alone and consolidated basis in accordance with IAS 39 and IFRS 10.

Stand alone basis

Pass through test

Under the pass through test, the obligation to pay the cashflows from the mortgages to Warwick Finance 1 and Warwick Finance 2 was met since payments from the mortgage borrower are made into the collection accounts required to be transferred to Warwick Finance 1 and Warwick Finance 2, respectively, 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 and Warwick Finance 2 have been transferred. Whilst the Bank retains an interest in Class A notes of both structured entities, the holders of residual certificates are independent 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 securitised as part of these transactions. The Bank has concluded that the transfer of substantially all risks and rewards test is therefore met.

Requirement to consolidate the results of Warwick Finance 1 and Warwick Finance 2

Variable rights of return

The Bank has assessed whether it has exposure or rights to variable returns from involvement with Warwick Finance 1 and Warwick Finance 2, and if it has the ability to affect those returns.

Up until 1 August 2015, the Bank owned WMSL, which provided services to Warwick Finance 1, however the Bank only acted as agent for junior and residual noteholders and not as a principal acting in its own interest. Hence the Bank had no power over Warwick Finance 1 and was 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 Warwick Finance 1. The Bank therefore concluded that Warwick Finance 1 should not be consolidated into its results.

The Bank closed its second whole structure securitisation of its Non-core optimum residential mortgage portfolio through the issuance of notes and residual certificates by Warwick Finance 2 after the date which the Bank sold WMSL. The Bank therefore concluded that Warwick Finance 2 should not be consolidated into its results.

The conclusion that Warwick 1 and 2 should not be consolidated into the Bank's results was made with full regard to the nature of the return associated with the Bank retained notes of both structures.

3. 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 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 divisions is provided in the detailed financial review.

	Core					Non-core			
	Retail	BaCB	Treasury	Other[1]	Total Core	Corporate CoAM	Optimum	Total Non-core	Total
2015									
Net interest income	**421.7**	**41.9**	**(5.8)**	**2.8**	**460.6**	**1.6**	**9.3**	**10.9**	**471.5**
Losses on asset sales	**–**	**–**	**(0.1)**	**(0.7)**	**(0.8)**	**(67.5)**	**(53.1)**	**(120.6)**	**(121.4)**
Non-interest income	**43.2**	**11.6**	**(6.4)**	**4.0**	**52.4**	**14.0**	**3.5**	**17.5**	**69.9**
Operating income	**464.9**	**53.5**	**(12.3)**	**6.1**	**512.2**	**(51.9)**	**(40.3)**	**(92.2)**	**420.0**
Direct costs	**(138.1)**	**(9.3)**	**(7.4)**	**(10.4)**	**(165.2)**	**(9.9)**	**(4.9)**	**(14.8)**	**(180.0)**
Impairment (losses)/gains on loans and advances	**(3.7)**	**1.3**	**–**	**2.1**	**(0.3)**	**37.9**	**11.0**	**48.9**	**48.6**
Contribution result	**323.1**	**45.5**	**(19.7)**	**(2.2)**	**346.7**	**(23.9)**	**(34.2)**	**(58.1)**	**288.6**
Operations and central costs									**(311.9)**
Operating project costs									**(49.7)**
Operating result									**(73.0)**
Remediation projects									**(124.5)**
Strategic projects									**(99.7)**
Share of post tax profits from joint ventures									**0.7**
Conduct/legal risk									**(193.7)**
Fair value amortisation									**(120.4)**
Loss before taxation									**(610.6)**
Income tax									**(12.2)**
Loss for the financial year									**(622.8)**

The Board relies primarily on net interest income to assess the performance of each segment. As a result interest income is reported on a net basis to the Board. The Bank's activities are primarily in the UK.

1. Included within 'Core - Other' is Unity Trust Bank. Unity Trust Bank operates in the corporate banking and social economy sectors on behalf of trade unions and is consolidated into the Bank's results on the basis of control. In December 2015 the Bank disposed of the majority of its shareholding in Unity Trust Bank. This is referred to in more detail in note 6.

	Core					Non-core				
					Total	Corporate			Total	
	Retail	BaCB	Treasury	Other[1]	Core	CoAM	Optimum	Illius	Non-core	Total
2014 (re-presented)										
Net interest income	396.3	46.1	(11.0)	13.4	444.8	9.3	43.2	(3.9)	48.6	493.4
Losses on asset sales	–	–	(2.1)	–	(2.1)	(11.1)	–	(1.2)	(12.3)	(14.4)
Non-interest income	105.2	14.9	(29.7)	–	90.4	17.2	4.7	2.8	24.7	115.1
Operating income	501.5	61.0	(42.8)	13.4	533.1	15.4	47.9	(2.3)	61.0	594.1
Direct costs	(154.8)	(14.6)	(10.3)	(8.9)	(188.6)	(17.1)	(2.9)	(4.2)	(24.2)	(212.8)
Impairment gains on loans and advances	1.8	1.6	–	0.1	3.5	152.6	15.6	–	168.2	171.7
Contribution result	348.5	48.0	(53.1)	4.6	348.0	150.9	60.6	(6.5)	205.0	553.0
Operations and central costs										(355.6)
Operating project costs										(71.0)
Operating result										126.4
Remediation projects										(145.6)
Strategic projects										(60.5)
Share of post-tax profits from joint ventures										0.6
Conduct/legal risk										(101.2)
Fair value amortisation										(83.9)
Loss before taxation										(264.2)
Income tax										39.0
Loss for the financial year										(225.2)

	2015	2014 Re-presented
Net interest income		
Total interest margin for reportable segments	**471.5**	493.4
Gains on asset sales	**1.0**	1.6
Interest fair value unwind	**(115.0)**	(89.0)
Provision for customer redress	**(58.3)**	(48.0)
Net interest income	**299.2**	358.0
Non-interest income		
Total non-interest income for reportable segments	**69.9**	115.1
Losses on asset sales	**(128.4)**	(16.0)
Interest fair value unwind	**–**	9.8
Non-interest income	**(58.5)**	108.9
Comprising:		
Net fee and commission income	**71.8**	122.4
Other operating expense	**(130.3)**	(13.5)
	(58.5)	108.9
Operating expenses		
Total operating expenses for reportable segments	**(180.0)**	(212.8)
Operations and central costs	**(311.9)**	(355.6)
Project costs	**(273.9)**	(277.1)
Interest fair value unwind	**(5.4)**	(4.7)
Provision for customer redress	**(0.5)**	(0.9)
Gains on asset sales	**6.0**	–
Impairment reclassification	**–**	(1.5)
Operating expenses	**(765.7)**	(852.6)
Interest fair value unwind		
Total interest unwind for reportable segments	**(120.4)**	(83.9)

Interest margin unwind	**115.0**	89.0
Non-interest income unwind	**–**	(9.8)
Operating expenses unwind	**5.4**	4.7
Interest fair value unwind	**–**	–
Impairment gains on loans and advances		
Total impairment gains on loans and advances for reportable segments	**48.6**	171.7
Impairment reclassification	**–**	1.5
Impairment gains on loans and advances	**48.6**	173.2

The 2014 comparatives have been re-presented as described in the detailed financial review.

		Core					Non-core		
					Total	Corporate		Total	
2015	**Retail**	**BaCB**	**Treasury**	**Other**	**Core**	**CoAM**	**Optimum**	**Non-core**	**Total**
Segment assets	**14,219.3**	**520.9**	**8,078.8**	**–**	**22,819.0**	**1,998.0**	**3,155.9**	**5,153.9**	**27,972.9**
Unallocated assets									**1,055.4**
Bank total assets									**29,028.3**

		Core					Non-core		
					Total	Corporate		Total	
2015	**Retail**	**BaCB**	**Treasury**	**Other**	**Core**	**CoAM**	**Optimum**	**Non-core**	**Total**
Segment liabilities	**19,725.2**	**2,682.0**	**3,267.4**	**–**	**25,674.6**	**211.3**	**–**	**211.3**	**25,885.9**
Unallocated liabilities									**1,779.1**
Bank total liabilities									**27,665.0**

		Core					Non-core		
					Total	Corporate		Total	
2014	Retail	BaCB	Treasury	Other	Core	CoAM	Optimum	Non-core	Total
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									1,353.7
Bank total assets									37,582.9

		Core					Non-core		
					Total	Corporate		Total	
2014	Retail	BaCB	Treasury	Other	Core	CoAM	Optimum	Non-core	Total
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									1,620.0
Bank total liabilities									35,568.4

Unallocated assets are assets which cannot be attributed to a reportable segment.

7. Net Interest income

	2015	2014 Re-presented
Interest receivable and similar income		
On financial assets not at fair value through profit or loss:		
On loans and advances to customers	**776.6**	1,052.6
On loans and advances to banks	**19.9**	24.1
On investment securities	**71.9**	75.8
Total of financial assets not at fair value through profit or loss	**868.4**	1,152.5
On financial assets at fair value through profit or loss:		
Net interest expense on financial instruments hedging assets	**(60.7)**	(106.7)
Net interest income on financial instruments not in a hedging relationship	**13.9**	19.0
Total interest receivable	**821.6**	1,064.8

	2015	2014
Interest expense and similar charges		
On financial liabilities not at fair value through profit or loss:		
On customer accounts	**(248.2)**	(405.2)
On bank and other deposits	**(257.7)**	(247.8)
On subordinated liabilities	**(28.6)**	(22.8)
Total of financial liabilities not at fair value through profit or loss	**(534.5)**	(675.8)
On financial liabilities at fair value through profit or loss:		
Net interest income/(expense) on financial instruments hedging liabilities	**8.9**	(21.4)
Net interest income/(expense) on financial instruments not in a hedging relationship	**3.2**	(9.6)
Total interest expense	**(522.4)**	(706.8)

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 £143.5m (2014: £109.2m), further details of which are provided in note 39.

8. Net fee and commission income/(expense)

	2015	2014
Fee and commission income		
On items not at fair value through profit or loss	**131.8**	197.2
On trust or fiduciary activities that result from holding or investing in assets on behalf of others	**0.1**	0.1
Total fee and commission income	**131.9**	197.3

	2015	2014
Fee and commission expense		
On items not at fair value through profit or loss	**(59.7)**	(74.8)
On items at fair value through profit or loss	**(0.4)**	(0.1)
Total fee and commission expense	**(60.1)**	(74.9)

10. Operating expenses

	Note	**2015**	2014
Operating Expenses			
Staff costs	11	**287.5**	304.1
Administrative expenses		**258.3**	296.7
Depreciation of property, plant and equipment	23	**9.9**	13.3
Amortisation of intangible fixed assets	21	**29.5**	26.7
Impairment of property, plant and equipment	23	**–**	6.3
Impairment of intangible assets	21	**0.3**	3.1
Profit on sale of property, plant and equipment		**(3.0)**	(0.2)
Operating lease rentals		**23.0**	25.6
Financial Services Compensation Scheme Levies	32	**19.0**	24.4
Property provisions for liabilities and charges provided in the year	32	**3.4**	2.1
Other provisions for liabilities and charges provided in the year	32	**14.2**	24.7
Direct expenses from investment properties that generated rental income in the period		**–**	3.6
Direct expenses from investment properties that did not generate rental income in the period		**–**	0.2

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

	Note	**2015**	2014
Incurred outside the ordinary course of business			
Investment, integration and rationalisation costs		**79.6**	40.7
Bank separation costs		**44.0**	72.9
Impairment of property, plant and equipment	23	–	8.4
Total of items incurred outside the ordinary course of business		**123.6**	122.0

Included within Bank separation costs is £8.9m provided in the year, see note 32.

The 2014 Bank separation costs included in the table above are the net impact of a charge of £94.5m and a utilisation of £21.6m.

11. Staff costs

	Note	**2015**	2014
Wages and salaries		**157.6**	180.6
Social security costs		**14.5**	16.0
Pension costs:			
Defined benefit plans	34	**5.0**	4.9
Defined contribution plans	34	**17.8**	26.1
Other staff costs		**92.6**	76.5
Total staff costs		**287.5**	304.1

Average number of employees

The average number of persons working for the Bank during the year is as follows:

	No. of employees 2015	No. of employees 2014
Full time	**4,463**	4,772
Part time	**1,251**	1,630
	5,714	6,402

Employees of the Bank were employed by CFS Management Services Limited (CFSMS) until 20 December 2013 and staff costs recharged to the Bank. At the beginning of 2014, the majority of the Bank's employees had their employment contracts transferred from CFSMS to The Co-operative Bank plc. The transfer was required to support the legal separation of the Bank from The Co-operative Group. This transfer took place under the Transfer of Undertakings (Protection of Employment) Regulations 2006.

12. Income tax

	Note	2015	2014
Current tax			
Current year		**47.6**	(22.3)
Prior year		**(0.1)**	7.8
Total current tax		**47.5**	(14.5)
Deferred tax			
Current year	33	**(27.6)**	(24.5)
Prior year	33	**(3.2)**	–
Impact of corporation tax rate change	33	**(4.5)**	–
Total deferred tax		**(35.3)**	(24.5)
Total tax charge/(credit)		**12.2**	(39.0)

In addition to the above, included within other comprehensive income is a current tax credit of £3.9m (2014: tax charge of £12.5m) and a deferred tax charge of £12.5m (2014: £8.7m).

Further information on deferred tax is presented in note 33.

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	2015	2014
Loss before taxation		**(610.6)**	(264.2)
Tax calculated at a rate of 20.25% (2014: 21.49%)		**(123.6)**	(56.8)
Effects of:			
Unrecognised deferred tax	33	**74.7**	22.7
Adjustment to group relief debtor		**50.6**	–
Expenses not deductible for tax purposes		**22.7**	(4.4)
Discount of group relief debtor		**(5.2)**	(9.7)
Impact of corporation tax rate change		**(4.5)**	–
Adjustments to tax charge in respect of prior periods		**(3.3)**	7.7
Other differences		**0.8**	(1.8)
Depreciation of capital expenditure not qualifying for capital allowances		**–**	1.5
Write off of deferred tax		**–**	1.8
		12.2	(39.0)

Amounts receivable from The Co-operative Group for tax losses surrendered and changes in that amount are recorded as an adjustment to the tax expense. The group relief debtor adjustment has arisen as a result of a revised repayment profile provided by the Co-operative Group Limited. For further information on the group relief receivable, refer to note 2. Expenses not deductible for tax purposes includes provisions for compensation payments arising after 8 July 2015 for which tax relief has been restricted following a change in legislation.

13. Earnings per share

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

	Note	**2015**	2014
Loss attributable to equity shareholders of the Bank		**(623.3)**	(226.6)
Number of Ordinary shares in issue (millions)			
At the beginning of the year		**451.5**	250.0
Issue of new ordinary shares	38	**–**	200.5
Issue of bonus shares	38	**–**	1.0
At the end of the year		**451.5**	451.5
Weighted average number of ordinary shares in issue (millions)		**451.5**	368.6
Basic losses per share (expressed in pence per share)		**(138.05)p**	(61.48)p

201.5m new shares were issued as part of the capital raising completed in May 2014, see note 38 for further details.

14. Non-current assets classified as held for sale

a) Non-current assets classified as held for sale

	Note	**2015**	2014
Property, plant and equipment	23	**3.4**	50.1
Intangible assets	21	**–**	0.3
Loans and advances to customers	17a	**–**	323.4
Cash and cash equivalents		**–**	9.1
Other receivables		**–**	4.4
		3.4	387.3

b) Liabilities directly associated with non-current assets classified as held for sale

	2015	2014
Other liabilities, accruals and deferred income	**–**	6.6
Current tax liabilities	**–**	1.0
Provision for liabilities and charges	**–**	0.3
	–	7.9

Non-current assets presented as held for sale relate solely to a number of branch assets which are currently being marketed for sale, with the expectation that these sales will be completed by the end of 2016. Impairment losses of £0.3m were recognised on classification of these assets as held for sale.

All assets classified as held for sale in 2014 were sold in 2015.

15. Cash and balances at central banks

	2015	2014
Cash in hand	**187.3**	218.0
Balances with the Bank of England other than mandatory reserve deposits	**2,445.6**	4,489.5
Included in cash and cash equivalents	**2,632.9**	4,707.5
Mandatory reserve deposits with the Bank of England	**45.6**	57.8
	2,678.5	4,765.3

Mandatory reserve deposits are not available for use in the Bank's day-to-day operations, are non-interest bearing and are not included in cash and cash equivalents.

16. Loans and advances to banks

	2015	2014
Items in course of collection from other banks	**18.3**	63.3
Placements with other banks	**488.5**	682.2
Included in cash and cash equivalents	**506.8**	745.5
Other loans and advances to banks	**364.2**	862.9
	871.0	1,608.4

17. a) Loans and advances to customers

	Note	**2015**	2014
Gross loans and advances		**19,935.6**	26,240.7
Less: allowance for losses		**(245.2)**	(539.9)
Classified as held for sale	14	**–**	(323.4)
		19,690.4	25,377.4

Loans and advances to customers include £174.0m (2014: £182.7m) of financial assets at fair value through income or expense designated at initial recognition to eliminate or significantly reduce a measurement or recognition inconsistency, and £4.2m of financial assets held for trading. Of these, £103.9m (2014: £78.4m) are secured by real estate collateral.

Loans and advances to customers include £3.2bn (2014: £7.9bn) securitised under the Bank's securitisation and covered bond programmes. The Bank remains exposed to substantially all of the risks and rewards of ownership of these assets. Included within the Bank's deposits by banks are £10.1m (2014: £10.1m) of loans from external third parties and within the Bank's debt securities in issue are £2.3bn (2014: £2.9bn) of fixed and floating rate notes, all secured on these mortgage assets.

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**
2015					
At the beginning of the year	**4.5**	**110.0**	**396.3**	**29.1**	**539.9**
Balances with debt collection agencies[1]	**–**	**–**	**–**	**–**	**–**
Disposal of UTB	**(2.1)**	**(0.5)**	**–**	**–**	**(2.6)**

(Release)/charge against profits[2]	**(1.3)**	**4.2**	**(22.3)**	**(18.3)**	**(37.7)**
Amounts written back/(written off)	**2.7**	**(9.1)**	**(244.2)**	**–**	**(250.6)**
Unwind of discount allowance	**–**	**(2.3)**	**(1.5)**	**–**	**(3.8)**
Interest charged on impaired loans	**–**	**–**	**–**	**–**	**–**
At the end of the year	**3.8**	**102.3**	**128.3**	**10.8**	**245.2**

1. The movement in the allowance for losses on loans and advances in relation to balances with debt collection agencies is immaterial and is incorporated within the (release)/charge against profits for the year.
2. The net impairment credit in the Bank's income statement is £48.6m (2014: £173.2m credit). This includes amounts recovered by the Bank of £7.5m (2014: £2.3m) against amounts previously written off.

The net impairment also includes a provision release of £44.3m (2014: £1.5m charge) made against fair value adjustments for hedged risk during the year (see note 17b).

This is summarised in the table below:

	Note	**2015**
Net impairment release shown in income statement		**(48.6)**
Amounts recovered against amounts previously written off		**7.5**
Transfer to loss on sale of assets - loans and receivables		**(40.9)**
Provision against fair value adjustment for hedged risk	17b	**44.3**
Release against profits shown above		**(37.7)**

Core provisions are analysed in further detail below:

	Core						
	Retail		**BaCB**		**Other**		**Total**
	Individual	**Collective**	**Individual**	**Collective**	**Individual**	**Collective**	**Core**
2015							
At the beginning of the year	**1.0**	**107.3**	**1.4**	**2.2**	**2.1**	**0.5**	**114.5**
Balances with debt collection agencies	**–**	**–**	**–**	**–**	**–**	**–**	**–**
Disposal of UTB	**–**	**–**	**–**	**–**	**(2.1)**	**(0.5)**	**(2.6)**
(Release)/charge against profits	**(1.4)**	**5.6**	**0.1**	**(1.4)**	**–**	**–**	**2.9**
Amounts written back/(written off)[3]	**3.2**	**(9.1)**	**(0.5)**	**–**	**–**	**–**	**(6.4)**
Unwind of discount allowance	**–**	**(2.3)**	**–**	**–**	**–**	**–**	**(2.3)**
Interest charged on impaired loans	**–**	**–**	**–**	**–**	**–**	**–**	**–**
At the end of the year	**2.8**	**101.5**	**1.0**	**0.8**	**–**	**–**	**106.1**

Non-core provisions are analysed in further detail below:

	Non-core				
	Corporate		**Optimum**		**Total**
	Individual	**Collective**	**Individual**	**Collective**	**Non-core**
2015					
At the beginning of the year	**386.8**	**16.7**	**9.5**	**12.4**	**425.4**
Balances with debt collection agencies	**–**	**–**	**–**	**–**	**–**
Charge/(release) against profits	**12.6**	**(9.2)**	**(34.9)**	**(9.1)**	**(40.6)**
Amounts (written off)/written back[3]	**(279.5)**	**–**	**35.3**	**–**	**(244.2)**
Unwind of discount allowance	**(1.5)**	**–**	**–**	**–**	**(1.5)**
Interest charged on impaired loans	**–**	**–**	**–**	**–**	**–**

At the end of the year	**118.4**	**7.5**	**9.9**	**3.3**	**139.1**

3. 'Retail - Individual' and 'Optimum - Individual' both contain fair value reversals of £3.7m and £40.2m respectively. These balances are within the 'Amounts written off' rows within the above tables.

2014 loans and advances to customers comparisons are shown below:

	Core		Non-core		
	Individual	Collective	Individual	Collective	Total
2014					
At the beginning of the year	10.7	167.8	724.5	49.4	952.4
Balances with debt collection agencies[4]	–	39.6	–	–	39.6
(Release)/charge against profits	(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

	2014
Net impairment release shown in income statement	(173.2)
Amounts recovered against amounts previously written off	2.3
Provision against fair value adjustment for hedged risk	(1.5)
Release against profits shown above	(172.4)

4. A review of the Bank's relationships with debt collection agencies in 2014 concluded that the bank substantially retained all of the risk and rewards associated with such relationships. The related gross receivables of £41.4m and associated allowance of £39.6m was therefore recognised as at 31 December 2014.

Core provisions are analysed in further detail below:

	Core						
	Retail		BaCB		Other[1]		Total
	Individual	Collective	Individual	Collective	Individual	Collective	Core
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 against profits	(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. 'Core – 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
2014					
At the beginning of the year	698.4	40.0	26.1	9.4	773.9
(Release)/charge against profits	(129.0)	(23.3)	(18.3)	3.0	(167.6)
Amounts written 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

The overall write back of impairment is largely due to improved credit conditions and the disposal of Non-core assets at favourable prices, as part of the Bank's strategy to exit these books.

Loans and advances to customers include finance lease receivables:

	2015	2014
Gross investment in finance leases may be analysed as follows:		
No later than one year	**7.3**	14.3
Later than one year and no later than five years	**18.9**	47.8
Later than five years	**17.3**	51.0
	43.5	113.1
Unearned future finance income on finance leases	**(10.7)**	(30.4)
Net investment in finance leases	**32.8**	82.7
The net investment in finance leases may be analysed as follows:		
No later than one year	**5.4**	9.0
Later than one year and no later than five years	**14.4**	33.1
Later than five years	**13.0**	40.6
	32.8	82.7

There are no unguaranteed residual values for any of the finance leases.

The Bank enters into finance lease and hire purchase arrangements with customers in a wide range of sectors including transport, retail and utilities.

17. b) Fair value adjustments for hedged risk

The Bank has entered into interest rate swaps that protect it from changes in interest rates on the floating rate liabilities that fund its portfolio of fixed rate mortgages. Changes in the fair values of these swaps are offset by changes in the fair values of the fixed rate mortgages.

	2015	2014
Gross fair value adjustments for hedge risk	**98.0**	196.8
Less: impairment provision	**(4.0)**	(48.3)
	94.0	148.5

Movements on impairment provision on fair value adjustments for hedge risk as shown below

	2015	2014
At the beginning of the year	**48.3**	46.8
(Release)/charge against profits	**(44.3)**	1.5
At the end of the year	**4.0**	48.3

18. Investment securities

a) Loans and receivables

	2015	2014
Loans and receivables:		
Listed	**15.0**	18.1
Unlisted	**–**	–
Total gross investment securities – loans and receivables	**15.0**	18.1
Less: allowance for losses	**–**	–
Total net investment securities – loans and receivables	**15.0**	18.1

Movement in investment securities – loans and receivables:

	2015	2014
At the beginning of the year	**18.1**	23.6
Disposals and maturities	**(3.2)**	(8.5)
Exchange adjustments	**–**	(0.5)
Amortisation	**0.1**	–
Release and utilisation of impairment provision	**–**	6.4
Movement in interest accrual	**–**	(2.9)
At the end of the year	**15.0**	18.1

b) Available for sale

	2015	2014
Available for sale:		
Listed	**4,296.8**	3,022.4
Unlisted	**–**	145.1
Total gross investment securities (available for sale)	**4,296.8**	3,167.5
Less: allowance for losses	**–**	–
Total net investment securities (available for sale)	**4,296.8**	3,167.5
Included in cash and cash equivalents	**–**	115.0

Included in investment securities are repurchase receivables of £517.0m. These receivables are gilts subject to repurchase transactions where the transferee has the ability to re-pledge or sell the assets.

Movement in investment securities – available for sale:

	2015	2014
At the beginning of the year	**3,167.5**	2,732.4
Acquisitions	**1,916.3**	1,940.1
Disposals and maturities	**(404.9)**	(1,644.5)
Disposal of UTB[1]	**(338.7)**	–
Fair value movements through equity	**(19.1)**	44.7
Fair value movements through income or expense	**(17.7)**	81.4
Amortisation	**(6.7)**	(8.9)
Release and utilisation of impairment provision	**–**	20.0
Movement in interest accrual	**0.1**	2.3
At the end of the year	**4,296.8**	3,167.5

1. Majority of Bank's shareholding in UTB was disposed of in the year. See note 6.

Impairment analysis of investment securities – available for sale

	2015	2014
At the beginning of the year	–	20.0
Release for the year	–	(1.1)
Utilised during the year	–	(18.9)
At the end of the year	–	–

c) Fair value through profit or loss

	2015	2014
Fair value through profit or loss:		
Listed	**582.4**	1,236.9
Unlisted	–	–
Total gross investment securities (FVTPL)	**582.4**	1,236.9
Less: allowance for losses	–	–
Total net investment securities (FVTPL)	**582.4**	1,236.9

Movement in investment securities (FVTPL):

	2015	2014
At the beginning of the year	**1,236.9**	1,743.4
Acquisitions	–	338.8
Disposals and maturities	**(639.9)**	(893.1)
Fair value movements through profit or loss	**(10.7)**	53.4
Movement in interest accrual	**(3.9)**	(5.6)
At the end of the year	**582.4**	1,236.9

d) Analysis of investment securities by issuer

	2015	2014
Investment securities issued by public bodies:		
Government securities	**2,518.1**	3,210.3
Other public sector securities	**87.2**	339.7
Total investment securities issued by public bodies	**2,605.3**	3,550.0
Investment securities issued by other issuers:		
Bank and building society certificates of deposits	–	145.1
Other debt securities:		
Other floating rate notes	**674.2**	709.3
Mortgage backed securities	**1,614.7**	18.1
Total investment securities issued by other issuers	**2,288.9**	872.5
Total investment securities	**4,894.2**	4,422.5

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

19. Derivative financial instruments

The Bank has entered, as principal, into various derivatives either as economic hedges which are treated as held for trading (not in a qualifying hedge relationship), or in a qualifying hedge accounting relationship for the management of interest rate risk and foreign exchange rate risk. Positive and negative fair values have not been netted off as the Bank does not have a legal right of offset.

Non-trading derivatives

Non-trading transactions comprise derivatives held for hedging purposes to manage the asset and liability positions of the Bank. Derivatives used to manage interest rate related positions include swaps, caps and floors, forward rate agreements and exchange traded futures. The foreign exchange rate positions are managed using forward currency transactions and swaps. Equity risk is managed using equity swaps.

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

	2015		2014	
	Fair value		Fair value	
	Assets	**Liabilities**	Assets	Liabilities
Derivatives held for non-trading purposes				
Derivatives designated as cash flow hedges:				
Interest rate swaps	**35.1**	**(9.2)**	46.1	(16.7)
Derivatives designated as fair value hedges:				
Interest rate swaps	**29.3**	**(189.6)**	0.6	(341.2)
Cross currency interest rate swaps	**157.8**	**–**	173.4	(17.8)
Derivatives held for non-trading purposes for which hedge accounting has not been applied:				
Interest rate swaps	**124.8**	**(143.6)**	198.2	(174.2)
Cross currency interest rate swaps	**2.2**	**(0.3)**	–	–
Forward currency transactions	**2.1**	**(4.0)**	0.6	(0.6)
OTC interest rate options	**0.2**	**(0.2)**	0.9	(0.1)
Equity swaps	**18.6**	**–**	50.9	(1.1)
Total derivative assets/(liabilities) held for non-trading purposes	**370.1**	**(346.9)**	470.7	(551.7)
Total recognised derivative assets/(liabilities)	**370.1**	**(346.9)**	470.7	(551.7)

The derivatives designated as cash flow hedges are interest rate swaps and futures used to hedge interest rate risk in the Bank's retail operations. Cash flows are hedged by quarterly time periods for durations up to 10 years. During the year there were no forecast transactions for which hedge accounting had previously been used but are no longer expected to occur.

In line with industry standards, credit valuation adjustments (CVAs) and debit valuation adjustments (DVAs) are applied to non-collateralised swaps representing the fair value measurement of counterparty risk. The net credit adjustment across the portfolio at the end of 2015 was £3.2m (2014: £3.9m). CVAs and DVAs are not applied to derivatives that are fully cash collateralised.

26. Deposits by banks

	2015	2014
Items in course of collection	**31.8**	37.9
Deposits from other banks	**694.1**	577.5
	725.9	615.4

Included within deposits from other banks are liabilities of £671.2m (2014: £nil) secured on investment securities with a carrying value of £710.4m (2014: £nil) which have been sold under sale and repurchase agreements (note 39).

27. Customer accounts – capital bonds

	2015	2014
Retail	**77.4**	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 £77.4m (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 year is £20.9m (2014: £37.8m). However, taking into account changes in fair value of the associated swaps, the net impact to the income statement for the year is £nil (2014: £1.5m).

28. Debt securities in issue

	2015	2014
Fixed and floating rate notes	**2,554.3**	3,443.6

The Bank has entered into cross currency interest rate swaps that protect it from changes in exchange rates and interest rates on its debt securities in issue. Where appropriate, the Bank applies fair value hedge accounting to reduce the accounting volatility from these positions.

Debt securities in issue include fixed and floating rate notes, the majority of which are secured on portfolios of variable and fixed rate mortgages. Some of these notes (securitisations) are redeemable in part from time to time, with such redemptions being limited to the net capital received from mortgagors in respect of the underlying assets. There is no obligation for the Bank to make good any shortfall out of general funds. Other notes (covered bonds secured and certificates of deposit) require the Bank to repay contractual amounts due on specified maturity dates.

32. Provisions for liabilities and charges

	Note	**Property**	**FSCS levies**	**PPI**	**Conduct/ legal**	**Separation**	**Other**	**Total**
2015								
At the beginning of the year		**24.4**	**12.7**	**73.6**	**362.5**	**112.3**	**32.0**	**617.5**
Transferred from CFSMS		**23.8**	**–**	**–**	**–**	**–**	**6.6**	**30.4**
Provided/(released) in the year:								
Interest income		**–**	**–**	**–**	**58.3**	**–**	**–**	**58.3**
Operating expense	10	**3.4**	**19.0**	**–**	**–**	**8.9**	**14.2**	**45.5**
Provision for customer redress		**–**	**–**	**71.8**	**63.6**	**–**	**(0.5)**	**134.9**
Utilised during the year		**(7.9)**	**(20.7)**	**(58.4)**	**(215.7)**	**(56.9)**	**(27.5)**	**(387.1)**
Disposal of UTB[1]		**–**	**(0.2)**	**–**	**–**	**–**	**(0.1)**	**(0.3)**

At the end of the year	**43.7**	**10.8**	**87.0**	**268.7**	**64.3**	**24.7**	**499.2**
Provisions were analysed as follows:							
Amounts falling due within one year	**26.9**	**10.8**	**40.7**	**246.1**	**64.3**	**23.0**	**411.8**
Amounts falling due after one year	**16.8**	**–**	**46.3**	**22.6**	**–**	**1.7**	**87.4**
Total provisions	**43.7**	**10.8**	**87.0**	**268.7**	**64.3**	**24.7**	**499.2**

	Note	Property	FSCS levies	PPI	Conduct/ legal	Separation	Other	Total
2014								
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	10	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
Total provisions		24.4	12.7	73.6	362.5	112.3	32.0	617.5

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

1. Majority of Bank's shareholding in UTB was disposed of in the year. See note 6.

Property

The Bank has a number of leasehold properties available for rent. Provisions are made when either the sub-lease income does not cover the rental expense or the property is vacant. The provision is based on the expected outflows during the remaining periods of the leases. In addition, dilapidation provisions are recorded to the extent that the Bank has incurred dilapidations and/or the dilapidation clause within the contract has been invoked. During the year £0.3m (2014: £2.7m) has been provided for this.

Financial Services Compensation Scheme (FSCS) levies

In common with other regulated UK deposit takers, the Bank pays levies to the FSCS to enable the FSCS to meet claims against it. During 2008 and 2009 claims were triggered against the FSCS in relation to a number of financial institutions. The compensation paid out to consumers is currently funded through loans from HM Treasury. The Bank 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 2015/16. From 2013, the FSCS had also started to repay the principal of the

Treasury loans and a further levy has been raised in 2013/14, 2014/15 and 2015/16 for the expected capital shortfall for these loans, so that they are fully repaid by March 2016. The total levy to be raised is £1,019.0m over three years, with the first instalment of £363.0m collected in 2013 and the second instalment of £399.0m collected in 2014. The Bank has provided £10.8m as at 31 December 2015 (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. Of the amount paid £10.7m and £9.5m is in respect of its 2014/15 interest levy and share of the capital levy respectively in 2015.

Payment Protection Insurance (PPI)

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

The FSA issued a policy statement in August 2010, which amended the 'Disputes Resolution: Complaints' section of the FSA Handbook, setting out new rules for handling complaints, including complaints of PPI mis-selling. The Bank must comply with the policy statement which requires complainants to receive adequate redress and the Bank to deliver fair outcomes and treat customers fairly including non-complainants. An additional provision of £71.8m (2014: £5.0m) has been recognised in the year, in respect of the total expected cost to the Bank of carrying out this work and paying compensation, making total provisions raised of £423.8m (2014: £352.0m). This is discussed in more detail in note 2.

Conduct/legal provisions

During the year the Bank provided an additional £58.3m (2014: £48.0m) in respect of customer redress due to breaches of the technical requirements of the Consumer Credit Act.

The £63.6m (2014: £43.8m) charged through provision for customer redress consists of £40.4m in relation to CCA delivery costs, £16.8m in relation to packaged accounts and a £6.4m increase of other conduct related provisions.

Other

The Bank is engaged in commercial contractual discussions with certain providers of outsourced services. Provisions have been recognised within Other Provisions above where the Bank is able reliably to estimate any financial liabilities associated with such discussions.

33. Deferred tax

The movements on the deferred tax accounts are as follows:

	2015			2014		
	Deferred tax asset	**Deferred tax liability**	**Total**	Deferred tax asset	Deferred tax liability	Total
Deferred tax at the beginning of the year	**21.0**	**(84.0)**	**(63.0)**	25.1	(103.0)	(77.9)
(Charged)/credited to the income statement:						
Current year	**(8.2)**	**35.8**	**27.6**	5.5	19.0	24.5
Prior year	**3.2**	**–**	**3.2**	–	–	–
Impact of corporation tax rate change	**4.1**	**0.4**	**4.5**	–	–	–
	(0.9)	**36.2**	**35.3**	5.5	19.0	24.5
Charged to other comprehensive income:						

Cash flow hedges	**–**	**–**	**–**	(8.7)	–	(8.7)
Available for sale	**(12.5)**	**–**	**(12.5)**	–	–	–
	(12.5)	**–**	**(12.5)**	(8.7)	–	(8.7)
Reclassified to assets held for sale	**–**	**–**	**–**	(0.9)	–	(0.9)
Deferred tax at the end of the year	**7.6**	**(47.8)**	**(40.2)**	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.

	2015		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	**20.4**	**–**	12.1	–
Fair value adjustments – Bank subsidiaries	**–**	**(44.9)**	–	(76.4)
Other temporary differences	**7.5**	**(2.9)**	21.0	(7.6)
Cash flow hedges	**(11.2)**	**–**	(11.5)	–
Unrealised appreciation on investments	**(13.1)**	**–**	(0.6)	–
Capital losses	**4.0**	**–**	–	–
	7.6	**(47.8)**	21.0	(84.0)

Net deferred tax assets expected to be recoverable after one year are £4.6m (2014: £21.0m).

Other temporary differences for the Bank totalling £4.6m (2014: £13.4m) relate to temporary differences 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 £44.9m (2014: £76.4m) relating to fair value adjustments is net of a deferred tax asset of £4.1m (2014: £3.3m).

The Directors consider the recoverability of deferred tax to be a critical accounting judgement as detailed in note 2.

The deferred tax credit in the income statement comprises:

	2015	2014
Capital allowances on fixed assets and assets leased to customers	**(8.3)**	(5.1)
Fair value adjustments	**(31.5)**	(16.5)
Other temporary differences	**8.8**	1.1
Cash flow hedges	**(0.3)**	1.2
FSCS levy provision	**–**	(5.2)
Capital losses	**(4.0)**	–
	(35.3)	(24.5)

Deferred tax assets totalling £356.2m (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 £1,669.8m (with deferred tax of £300.6m) and other temporary differences of £219.0m (with deferred tax of £55.6m). Deferred tax assets of £74.7m (2014: £22.7m) in respect of the current year have not been recognised.

During the year, effective from 1 April 2015, the standard rate of corporation tax in the UK changed from 21%

to 20%. Reductions in the UK corporation tax rate from 20% to 19% (effective from 1 April 2017) and 18% (effective from 1 April 2020) were substantively enacted on 18 November 2015. A banking surcharge tax of 8% will also apply to the Bank (effective from 1 January 2016) and this change was substantively enacted on 18 November 2015. Deferred tax has been calculated by reference to the most appropriate rate based on forecasts. On 16 March 2016, the Chancellor of the Exchequer announced a further reduction of the corporation tax rate to 17% effective from 1 April 2020; this change has not yet been substantively enacted.

During the year, effective from 1 April 2015, new tax legislation was introduced to restrict the proportion of banks' annual taxable profits that can be offset by tax losses arising prior to this date to 50%. On 16 March 2016, the Chancellor of the Exchequer announced that the proportion will be restricted further to 25% effective from 1 April 2016.

34. Pensions

Pension charge

The pension charge in the income statement at 31 December 2015 was £22.8m (2014: £31.0m) which includes £5.0m (2014: £5.0m) as the Bank's contribution to the Pace deficit recovery charge.

a) The Co-operative Pension Scheme (Pace)

The Bank participates in Pace, a hybrid scheme, consisting of a closed defined benefit section (Pace Complete) and a defined contribution section (Pace DC). The Pace scheme is considered to be a multi-employer scheme under IAS 19 Employee benefits (revised 2011) with The Co-operative Group being the Principal Employer.

In October 2015, Pace Complete closed to new members. Benefits built up in the scheme have been preserved and remain in the scheme with annual increases being applied in line with the scheme rules. From 29 October 2015, members in Pace Complete automatically began building up benefits in Pace DC (unless they opted out).

i. Scheme Background

At 31 December 2012 the scheme was recognised as a Group plan, since risks were shared between entities under the common control of The Co-operative Group. It was accounted for on a defined contribution basis since there was no contractual agreement or stated Co-operative Group policy for charging the net defined benefit cost for the scheme as a whole to individual participating entities. Therefore, the Bank did not recognise its share of the net defined benefit cost. The net defined benefit cost of the pension scheme was recognised fully by the sponsoring employer, which was the Co-operative Group Limited.

On 4 November 2013, The Co-operative Group and the Bank entered into an undertaking pursuant to which The Co-operative Group agreed with the Bank, subject to certain exceptions, not to require the Bank to cease to participate in Pace in connection with the LME or any subsequent reduction in The Co-operative Group's shareholding in the Bank (including to nil).

Following separation of the Bank from the wider Co-operative Group as a result of the LME, the Bank remained a participating employer in the Pace scheme. In early 2016, a tripartite steering group with representatives from the Bank, The Co-operative Group and the Pace Trustee was established to progress the separation of the Bank from Pace.

ii. Risks arising from the scheme

As a multi-employer pension scheme, Pace exposes the participating businesses to actuarial risks associated with the current and former employees of the other participating employers. The proportion of Pace liabilities accrued by members whilst employees of the Bank is believed to represent a minority of total Pace liabilities. The Bank could, however, be liable for funding a greater proportion of Pace liabilities.

There are, for example, liabilities in Pace relating to benefits accrued by members whilst employed by CFSMS and working in the Bank's business. On 23 January 2014, following the legal separation of the Bank from the wider Co-operative Group, employment contracts for the majority of those employees who spent most of their time working on behalf of the Bank were transferred from CFSMS to the Bank. This increased the number of Bank employees participating in the Pace scheme in 2014.

There may also be 'orphan liabilities' in Pace that do not relate to any current employer participating in Pace. The extent to which the Bank could be liable for funding a greater proportion of Pace liabilities will depend, inter alia, on what position is reached as to the Pace liabilities properly attributable to the Bank following discussions with The Co-operative Group and the Pace Trustee. Whilst these discussions are underway as at March 2016, they are not yet sufficiently progressed so as to have reached a conclusion on the matter of liability share.

There is, therefore, currently insufficient information available to consistently and reliably identify the Bank's share of Pace liabilities and employer costs. For the above reasons the pension costs in respect of Pace are accounted for on a defined contribution basis in accordance with IAS 19 (revised 2011). Pension costs are recognised as an expense in the Bank income statement on a defined contribution basis as explained below, based on a fixed percentage as agreed with the Pace Trustee.

The Pace scheme is not sectionalised and operates on a 'last man standing' basis. In the event that other participating employers become insolvent and the full statutory debt is not recovered on insolvency, the Bank would become liable for the remaining liabilities.

There is no agreed allocation of a deficit or surplus on (i) wind up of the plan; or (ii) the entity's withdrawal from the plan.

The key aspects of Pace are illustrated below.

iii. Scheme information

Risks arising in Pace are identified at The Co-operative Group level, with the impact of any changes to contribution assessed under the Bank's risk management framework. The Bank is therefore exposed to potential future increases in required contributions and capital held for pension risk. The Pace Trustee, in consultation with The Co-operative Group, is responsible for the risk management arrangements for Pace agreeing suitable contribution rates, investment strategy and for taking appropriate professional advice as required.

iv. Contribution payments

On an accounting basis the Pace scheme is in a surplus of £1,266.3m at 31 December 2015 (2014: surplus of £1,128.5m). Under the current arrangements the Bank does not have an unconditional right of refund of scheme assets on winding up or any right to reduction of contributions as a result of this surplus.

Prior to the scheme's closure to future benefit accrual, based on advice from a qualified actuary, the contributions in respect of future service in the defined benefit section were 18%.

v. Funding the liabilities

The Pace triennial valuation as at 5 April 2013 was completed on 21 July 2014. The funding shortfall for the entire scheme had increased from £248.0m per the previous triennial valuation as at 5 April 2010 to £600.0m as at 5 April 2013. The latest funding shortfall position calculated by the scheme actuary on an approximate basis as at 5 April 2015 was £304.0m. The level of funding for the Pace scheme is agreed between The Co-operative Group and the Pace Trustee. The Co-operative Group agreed a recovery plan with the Trustee of the scheme to contribute £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. The actual funding level is below the expected level at 5 April 2015, with the deficit being £205.0m higher than that estimated by the recovery plan.

On 19 August 2014, the Bank agreed to meet 20% of the total Pace deficit contributions at that date for a period of one year only. The Bank recognised £5.0m on 19 August 2014 as a result of this agreement which represented 12 months of deficit contribution being the time frame which was expected to elapse to the point that the Pace separation process is completed, which is ongoing as at March 2016. As a result, in 2015 the Bank committed an additional £5.0m p.a. to Pace, with the expectation the Pace separation would complete within the next 12 months. The liability in respect of the deficit contribution agreement dated 19 August 2014 as at 31 December 2015 was £2.5m (2014: £2.9m). The current recovery plan ending in 2019 between The Co-operative Group and the Pace scheme Trustees may however be insufficient to fund the latest valuation of the deficit. The Bank’s agreement on 19 August 2014 to meet 20% of the total Pace deficit contributions was predicated upon this percentage contribution not setting a precedent for future discussions on the separation of accrued Pace assets and liabilities between The Co-operative Group and the Bank. The Co-operative Group has undertaken to agree with the Bank its final proportion of employer contributions in Pace and, if not agreed, the matter will be referred to an independent third party. Accordingly, there is a wide range of outcomes regarding the duration and contribution requirements of a new schedule of contributions and recovery plan which make the overall contributions uncertain.

The next formal triennial valuation of Pace as at 5 April 2016 will not be completed until 2017, however a funding shortfall position calculated by the scheme actuary on an approximate basis arose in 2015. There is therefore a risk that in future periods the Bank will recognise significant liabilities in respect of the scheme in its accounts.

The Bank also pays contributions in respect of the employed members of the defined contribution sections of the scheme of between 2% and 16% of pensionable salaries. The key financial aspects of Pace are illustrated below for information. These amounts are not recognised within these financial statements.

vi. Key assumptions of the Pace pension scheme

The key aspects of the Pace scheme are as follows:

	2015	2014
The principal assumptions used to determine the liabilities of the Pace scheme are:		
Discount rate	**3.80%**	3.70%
Rate of increase in salaries	**3.55%**	3.30%
Future pension increases where capped at 5.0% per annum	**3.20%**	3.30%
Future pension increases where capped at 2.5% per annum	**2.20%**	2.50%
Assumptions used to determine net pension cost for the Pace scheme are:		
Discount rate	**3.70%**	4.45%
Rate of increase in salaries	**3.30%**	3.60%

The average life expectancy (in years) for mortality tables used to determine scheme liabilities for the Pace scheme at the 2015 year end is:

	Male	**Female**
Life expectancy:		
Member currently aged 65 (current life expectancy)	**22.9**	**25.2**
Member currently aged 45 (life expectancy at age 65)	**25.2**	**27.4**

The balance sheet amounts attributable to the entire scheme are as follows:

	2015	2014
Fair value of plan assets	**9,185.0**	9,153.7
Present value of funded obligations	**(7,918.4)**	(8,024.8)
	1,266.6	1,128.9
Present value of unfunded obligations	**(0.3)**	(0.4)
	1,266.3	1,128.5

The asset allocations at the year end were as follows:

	2015	2014
Equities	**1,906.8**	1,808.1
Liability driven investments	**5,524.5**	5,228.7
Alternative growth	**850.0**	964.8
Property	**305.0**	318.6
Other	**598.7**	833.5

The table below shows the value of the assets in each category which have a quoted market price:

	2015	2014
Equities	**1,906.8**	1,808.1
Liability driven investments	**5,524.5**	4,912.7
Other	**150.8**	378.9

b) Britannia Pension Scheme (Britannia Scheme)

The Britannia Scheme is a defined benefit scheme.

i. Scheme Background

In 2009, following the transfer of engagements of Britannia Building Society, CFSMS, a Co-operative Group subsidiary, became principal employer of the scheme, and the three other participating employers of the Britannia Scheme were Bank wholly owned subsidiary entities. Until December 2015, the Bank itself was not a participating employer in the scheme, but provided a guarantee to the Britannia Trustee in relation to funding the pension obligations.

The scheme closed to new members on 6 October 2010, with active members at the date of closure being invited to join the respective defined benefit or contribution Co-operative Pension Scheme for future pension accrual. The Trustee agreed to wind up the defined contribution section from February 2013, with any remaining members given the option of transferring their funds to an alternative approved pension arrangement, or securing benefits with an insurance contract. No future service contributions are payable to the scheme due to the closure of the scheme to future accrual. This was only fully severed in October 2015. The weighted average duration of the defined benefit obligation of the Britannia Scheme is 23 years.

At 31 December 2012 the scheme was recognised as a Group plan since all participating entities were within common control of The Co-operative Group. The Bank and its subsidiary entities participating in the scheme (Platform, WMS and Britannia International) accounted for the scheme on a defined contribution basis, recognising the contribution paid as an expense in the income statement. Following separation of the Bank from the wider Co-operative Group as a result of the LME in 2013, the scheme was considered to be a multi-employer scheme under IAS 19 (revised 2011). At 31 December 2013 the Bank did not have sufficient information to reliably and consistently measure its share of the obligation and therefore the Bank accounted for the scheme on a defined contribution basis. During 2014, employment contracts for those employees who spent the majority of their time working on behalf of the Bank were transferred from CFSMS to the Bank. As a result of this transfer, whilst CFSMS remained the sponsoring employer of the scheme, the Bank recognised the total assets and liabilities of the scheme on the balance sheet as at 31 December 2014.

On the 23 December 2015, a Flexible Apportionment Arrangement (FAA) was executed, at which time the Co-operative Bank plc was named as a participating employer and replaced CFSMS as the principal employer, following which, CFSMS, WMS and PHL departed from the scheme with their share of the scheme's liabilities being transferred to the Bank. As the Bank recognised the total assets and liabilities of the scheme on its balance sheet, due to a guarantee it provided, the FAA has not had a significant impact on the Bank's exposure to the risks of the scheme.

Whilst the Britannia Scheme is in an accounting surplus, this has not been recognised on the balance sheet in accordance with IFRIC 14. The Bank has however recognised a £3.1m liability (2014: recognised £3.3m liability) representing unfunded pension liabilities of the Britannia Supplementary Pension and Life Assurance plan. There is no charge supplementary arrangement for certain Executive Directors. Benefits under this unfunded arrangement are valued on the same assumptions as the Britannia Scheme and are disclosed as unfunded obligations.

ii. Nature of benefits

The Britannia Scheme pays out pensions at retirement based on service to 6 October 2012 and final pay for employees who commenced employment prior to 1 September 2001, when it closed to new members.

iii. Funding the liabilities

Britannia Pension Trustees Limited is the corporate body that acts as 'Trustee' of the Britannia Scheme. UK legislation requires the Trustee to carry out valuations at least every three years and to target full funding against a basis that prudently reflects the scheme's risk exposure. The Scheme Actuary completed an actuarial valuation of the Scheme as at 5 April 2011, in accordance with the scheme specific funding requirements of the Pensions Act 2004. The results of the valuation showed that the Britannia Scheme had a shortfall of £3.7m. CFSMS (the previous sponsoring employer) 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 statutory deadline for the completion of the triennial valuation of the scheme's assets and liabilities as at 5 April 2014 has passed, although there is an expectation that the valuation will be concluded in early 2016. At this point, the Bank will be required to agree with the Trustees a schedule of contributions in respect of any deficit in the Britannia Scheme.

iv. Governance

The Chair of the Trustee Board is appointed by and from the Trustee Directors and the Board comprises an Independent Trustee, nominees of The Co-operative Bank and elected scheme members. The Trustee, in consultation with the Bank, is responsible for the risk management arrangements for the Britannia Scheme, agreeing suitable contribution rates, investment strategy and for taking professional advice as appropriate.

v. Risks associated with the Scheme

Risks arising in the Britannia Scheme are identified and assessed under the Bank's Risk Management Framework. The Bank is exposed to potential future increases in required contributions and capital held for pension risk.

Actions taken by the Pensions Regulator, changes to European legislation, or changes in the financial strength of the Bank could result in stronger funding standards, which could materially affect the Bank's cash flow and balance sheet. There is also a risk that changes in the assumptions for life expectancy, interest rates or in price inflation could result in a deficit in the scheme. Other assumptions used to value the defined benefit obligation are also uncertain, although their effect is less material.

The Bank previously granted a guarantee in respect of participating employers' liabilities in relation to the Britannia Scheme up to 105% funding on the section 179 Pensions Act 2004 valuation basis. This guarantee was extinguished as part of the FAA discussed above.

vi. Investment strategy

Some risk arises from the Britannia Scheme defined benefit section because the value of the asset portfolio and returns from it may be less than expected. There is also a risk of a mismatch between the Scheme's assets and liabilities and differences in sensitivity to changes in financial and demographic factors. The Trustee's objective is to invest the Scheme's assets in the best interest of the members and beneficiaries. Within this framework the Trustee has agreed a number of objectives to help guide them in their strategic management of the assets and control of the various risks to which the Britannia Scheme is exposed.

vii. Indirect participation

In 2015 the Bank paid approximately £1.0m (2014: £1.0m) to CFSMS in relation to Britannia Scheme pension costs. The pension cost shown in these accounts is the actual contribution paid by the Bank and three of its subsidiaries.

The key aspects of the defined benefit section of the Britannia scheme are as follows:

	2015	2014
The principal assumptions used to determine the liabilities of the Britannia defined benefit scheme are:		
Discount rate	**3.90%**	3.70%
Revaluation in deferment (CPI)	**2.20%**	2.20%
Future pension increases where capped at 5.0% per annum	**3.15%**	3.15%
Future pension increases where capped at 5.0% per annum, minimum 3.0%	**3.60%**	3.60%
Assumptions used to determine net pension cost for the Britannia defined benefit scheme are:		
Discount rate	**3.70%**	4.45%
Price inflation rate (RPI)	**3.20%**	n/a
Rate of increase in salaries	**n/a**	3.60%

The average life expectancy (in years) for mortality tables used to determine defined benefit scheme liabilities for the former Britannia Building Society scheme at the 2015 year end is:

	Male	**Female**
Life expectancy:		
Member currently aged 65 (current life expectancy)	**22.9**	**25.1**
Member currently aged 45 (life expectancy at age 65)	**25.2**	**27.5**

	2015	2014
Fair value of plan assets	**720.3**	728.5
Present value of funded obligations	**(639.9)**	(683.7)
	80.4	44.8
Pension surplus not recognised under IAS 19 (revised 2011)	**(80.4)**	(44.8)

Present value of unfunded obligations	**(3.1)**	(3.3)
	(3.1)	(3.3)

The amounts recognised in the income statement of the Bank are as follows:

	2015	2014
Interest expense on defined benefit obligation	**(24.9)**	(26.5)
Interest income on plan assets	**26.6**	27.7
Interest expense on effect of onerous liability	**(1.7)**	(1.2)
Total net interest cost	**–**	–
Administrative expenses	**(1.5)**	(1.5)
Defined benefit costs included in income statement	**(1.5)**	(1.5)

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

	2015	2014
Defined benefit obligation at the start of the year	**683.7**	604.2
Past service cost	**(6.0)**	–
Interest expense	**24.9**	26.5
Benefit payments from plan assets	**(21.8)**	(15.8)
Remeasurements:		
Effect of changes in demographic assumptions	**(6.7)**	12.0
Effect of changes in financial assumptions	**(30.9)**	56.8
Effect of experience assumptions	**(3.3)**	–
Defined benefit obligation at the end of the year	**639.9**	683.7

	2015	2014
Fair value of plan assets at the start of the year	**728.5**	630.7
Interest income	**26.6**	27.7
Employer contributions	**0.9**	–
Benefit payments from plan assets	**(21.8)**	(15.8)
Administrative expenses paid from plan assets	**(1.5)**	(1.5)
Return on plan assets (excluding interest income)	**(12.4)**	87.4
Fair value of plan assets at the end of the year	**720.3**	728.5

Changes in the effect of the asset ceiling are as follows:

		2015			2014	
	Asset	**Defined benefit obligation**	**Asset ceiling**	Asset	Defined benefit obligation	Asset ceiling
At the start of the year	**728.5**	**(683.7)**	**(44.8)**	630.7	(604.2)	(26.5)
Past service cost	**–**	**6.0**	**(6.0)**	–	–	–
Interest income/(expense)	**26.6**	**(24.9)**	**(1.7)**	27.7	(26.5)	(1.2)
Employer direct benefit payments	**0.9**	**–**	**(0.9)**	–	–	–
Administrative expenses paid from plan assets	**(21.8)**	**–**	**21.8**	(1.5)	–	1.5
Benefits paid	**(1.5)**	**21.8**	**(20.3)**	(15.8)	15.8	–
Actuarial (losses)/gains	**(13.1)**	**40.9**	**(27.8)**	87.4	(68.8)	(18.6)
Fair value of plan assets at the end of the year	**719.6**	**(639.9)**	**(79.7)**	728.5	(683.7)	(44.8)

The asset allocations at the year end were as follows:

	2015	2014

Equities	**126.0**	118.5
Liability driven investments	**452.2**	463.0
Alternative growth	**35.3**	49.1
Property	**81.7**	87.3
Other	**24.4**	10.6

The table below shows the fair value of the assets in each category which have a quoted market price:

	2015	2014
Equities	**126.0**	118.5
Liability driven investments	**415.9**	425.7
Other	**22.7**	9.3

Bank (unfunded) pension scheme

The Bank also operates a small unfunded pension scheme.

	2015	2014	2013	2012	2011
Price inflation rate (RPI)	**3.2%**	3.3%	3.6%	3.3%	3.3%
Rate of increase in salaries	**n/a**	3.3%	5.1%	4.8%	4.8%
Discount rate	**3.9%**	3.7%	4.7%	4.6%	4.6%

The assumptions used by the actuary were the best estimates chosen from a range of possible actuarial assumptions which, due to the timescales covered, may not necessarily be borne out in practice.

The values of the assets and liabilities of the unfunded pension scheme were:

	2015	2014
Present value of unfunded obligations	**(4.4)**	(4.7)
Deficit in scheme	**(4.4)**	(4.7)
Related unrecognised deferred tax asset	**1.1**	0.9
Net pension liability	**(3.3)**	(3.8)
Analysis of amount charged to income statement:		
Current service cost	**–**	–
Interest on pension scheme liabilities	**0.2**	0.2
	0.2	0.2

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

	2015	2014
Opening defined benefit liabilities	**4.7**	4.0
Current service cost	**–**	–
Interest on liabilities	**0.2**	0.2
Actuarial losses	**(0.3)**	0.7
Benefits paid	**(0.2)**	(0.2)
Closing defined benefit liabilities	**4.4**	4.7

Amounts recognised in the statement of comprehensive income:

	2015	2014
Actuarial losses on scheme liabilities during the period	**(0.3)**	0.7
Total scheme losses during the period	**(0.3)**	0.7

The amounts for the current year are as follows:

	2015	2014
Defined benefit obligation	**(4.4)**	(4.7)
Deficit in scheme	**(4.4)**	(4.7)
Experience adjustment on scheme liabilities	**–**	–
Experience adjustment on scheme assets	**–**	–

35. Contingent liabilities

The tables below provide the contract amounts and risk weighted amounts of contingent liabilities and commitments. The contract amounts indicate the volume of business outstanding at the balance sheet date and do not represent amounts at risk. The risk weighted amounts have been calculated in accordance with the CRD IV rules.

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

	Unaudited		Unaudited	
	Contract Amount 2015	**Risk weighted amount 2015**	Contract amount 2014 Re-presented	Risk weighted amount 2014 Re-presented
Contingent liabilities:				
Guarantees and irrevocable letters of credit	**21.0**	**15.0**	43.2	18.0
Other commitments:				
Undrawn formal standby facilities, credit lines and other commitments to lend (includes revocable and irrevocable commitments)[1]	**2,571.7**	**313.5**	2,862.9	448.5
	2,592.7	**328.5**	2,906.1	466.5

1. Undrawn loan commitments include revocable commitments which are unused credit card limits of £1,557.6m (2014: £1,787.3m).

During 2015, the Bank reviewed its interpretation of items comprising Forward Asset Purchases and now considers that they do not classify as other commitments. The effect of re-presentation is to reduce Other commitments by £154.9m at December 2014.

Assets pledged

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

See note 39 for further details of assets pledged.

Commitments under operating leases

The Bank leases various properties and equipment under non-cancellable operating lease arrangements. The leases have various terms, ranging from six months to 999 years. None of these leases are individually material and none have any material clauses. The table below discloses the minimum operating lease payments the Bank will be required to make over the remaining lives of the leases.

	Land and buildings 2015	**Equipment 2015**	Land and Buildings 2014	Equipment 2014
Falling due:				
Within one year	**14.0**	**–**	18.3	0.1
Between one and five years	**30.2**	**–**	46.3	0.3
In five years or more	**84.3**	**–**	51.5	–
	128.5	**–**	116.1	0.4

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

The total value of future minimum sub-lease payments expected to be received under non-cancellable sub-leases for the Bank was £13.9m (2014: £5.0m).

Indemnification agreement

The Bank has an indemnification agreement with CFSMS, accounted for as a guarantee under IFRS 4, in which the Bank has agreed to indemnify CFSMS against all and any liability, loss, damage, costs and expense arising from the agreement (under which CFSMS provides certain assets and services to the Bank). This agreement will remain in place until it is terminated after separation activities with the wider Co-operative Group are fully completed, but this will require the consent of CFSMS.

Conduct issues

Given the high level of scrutiny regarding financial institutions' treatment of customers and business conduct from regulatory bodies, the media and politicians, there is a possibility that certain aspects of the Bank's current or historic business, including, amongst other things, mortgages and relationship banking, may be determined by the FCA and other regulatory bodies or the courts as, in their opinion, not being conducted in accordance with applicable laws or regulations, or fair and reasonable treatment.

In particular, there is currently a significant regulatory focus on the sale practices and reward structures that financial institutions have used when selling financial products. There may also be other regulatory investigations and action against the Bank in the future in relation to conduct and other issues that the Bank is not presently aware of, including investigations and actions against it resulting from alleged mis-selling of financial products or the ongoing servicing of those financial products. The outcome of any ongoing disputes and legal, regulatory or other investigations or proceedings is currently uncertain.

Consumer Credit Act issues

The Consumer Credit Act regulates consumer lending and governs the way in which entities, including banks, providing consumer credit to retail customers carry out business. From 1 April 2014 the Financial Services and Markets Act 2000 also applies alongside certain retained provisions of the Consumer Credit Act. The Consumer Credit Act includes very detailed, prescriptive and highly technical requirements for lenders affecting customer documentation and which, in turn, impact how operational processes and IT systems are configured. While the Bank has undertaken a detailed analysis to identify certain instances where its documentation or processes have not been fully compliant with the technical requirements and has provided accordingly, it is not possible to rule out the possibility of other instances which have not yet been identified. Breaches may have the effect of triggering periods of non-compliance during which an affected customer is not liable to pay interest.

Debit interest refunds would therefore need to be made in certain cases where a period of non-compliance has been previously triggered, in the same way the Bank will be making such refunds as a consequence of the issues already identified. A provision of £124.8m is in place for these matters at the end of 2015, being the best estimate of the liability based on detailed legal analysis of whether breaches of the technical requirements have in fact occurred to date. In the event that such legal analysis and judgements are determined to be incorrect, the Bank could be exposed to further liabilities.

Proposed sale of the Bank's share in Visa Europe Limited (VE)

On 2 November 2015, Visa Inc. announced the proposed acquisition of VE of which the Bank is a member and shareholder. Completion of the deal is subject to regulatory approvals and is not expected to occur before 1 April 2016. In connection with the transaction, the Bank and certain other members of VE have entered into a Loss Sharing Agreement (LSA) pursuant to which the Bank has agreed, on a several and not joint basis, to indemnify Visa Inc. for certain losses which may be incurred as a result of existing and potential litigation relating to the setting and implementation of domestic MIF rates in the UK. This indemnification is up to a maximum amount of the upfront cash consideration to be received by the Bank, being approximately €50m. For any such losses, the new arrangement under the LSA will replace the potential uncapped indemnity under the existing VE Operating regulations, which will otherwise continue for claims outside the UK. The Preference Stock, the LSA and the continuation of the existing indemnity for claims outside the UK work together to provide Visa Inc. with protection against liabilities from MIF litigation in the VE territory. The Preferred Stock serves as a 'first loss' piece, such that the LSA indemnity is only triggered if, amongst other things, either (a) €1bn of losses have first been allocated to the value of the Preferred Stock in respect of liabilities in connection with UK domestic MIF claims, or (b) the value of the Preferred Stock is reduced to zero in respect of liabilities in connection with MIF claims across the VE territory.

The potential exists, therefore, for the entire value of the Bank's upfront consideration (cash and Preference Stock) to be eroded by liabilities incurred by Visa Inc. in connection with MIF litigation in the VE territory. However, at this stage, the Bank has concluded that there is no reliable estimate available of value of the potential exposure from existing and future litigation, assuming the deal closes. The fair value of VE shareholding has been remeasured based on the offer by Visa Inc. See note 20.

Regulatory and other investigations

The Bank is the subject of multiple regulatory and other investigations and enquiries into events at the Bank and circumstances surrounding them. These include:

- The Treasury announced by press release on 22 November 2013 that it intends to conduct an independent investigation into events at the Bank and the circumstances surrounding them from 2008, including the Verde transaction and Britannia merger. The investigation will review the conduct of Regulators and the Government but is not anticipated to commence until it is clear that it will not prejudice the outcome of the Financial Conduct Authority (FCA) and Prudential Regulation Authority (PRA) enforcement investigations.

- The Financial Reporting Council has launched an investigation under its Accountancy Scheme into the preparation, approval and audit of the Bank's accounts up to and including its 2012 annual accounts, which focuses on the role of the auditors and individual accountants.

The Bank is co-operating with the investigating authorities. It is not possible to estimate the financial impact upon the Bank should any adverse findings be made.

Legal proceedings

The Bank is engaged in various other legal proceedings involving claims by and against it which arise in the ordinary course of business, including debt collection, mortgage enforcement, consumer claims and contractual disputes. The Bank does not expect the ultimate resolution of any of these proceedings to which the Bank is party to have a material adverse effect on its results of operations, cash flows or the financial position of the Bank and has not disclosed the contingent liabilities associated with these claims. Provisions have been recognised for those cases where the Bank is able reliably to estimate the probable loss where the probable loss is not de minimis. See note 32.

Mortgage securitisation representations and warranties

In connection with the Bank's mortgage securitisations and covered bond transactions described in note 39 (Bank financial statements) and note 26 (Company financial statements), the Bank makes various representations and warranties relating to the mortgage loans, including in relation to ownership, compliance with legislation and origination procedures. If the representations and warranties are breached subject to any applicable materiality determination, the Bank may be required to repurchase the affected mortgage loans or in some circumstances pay compensation to the securitisation vehicle.

There is a risk that a number of the underlying matters giving rise to the conduct and legal provisions set out in note 32 could have given rise to breaches of such representations and warranties. Accordingly there is a risk that the Bank may be required to pay compensation or repurchase affected mortgage loans in amounts that may reduce the Bank's liquidity.

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

Pensions

There is uncertainty over the amount that the Bank will have to pay while it continues to participate in Pace. The Bank's obligations to contribute to Pace would increase significantly if another large employer in Pace becomes insolvent while the Bank continues to participate. If the Bank seeks to address these risks by terminating its participation, the default position is that material liabilities in respect of the deficit in Pace will arise. The Co-operative Group and the Bank have entered good faith discussions to manage this by seeking agreement so that the liabilities properly attributable to the Bank (and an equivalent proportion of assets) would be transferred to a separate scheme, or a segregated section of Pace, on the Bank's exit but, no arrangements have yet been agreed. There is therefore uncertainty over the amount that the Bank will have to pay in the event that it exits Pace. Separation of Pace will also require the co-operation of the Pace Trustees which may not be forthcoming.

The Pace scheme is not sectionalised and operates on a 'last man standing' basis. In the event that other participating employers become insolvent and the full statutory debt is not recovered on insolvency, the Bank would become liable for the remaining liabilities.

Other pensions risks and uncertainties include the risk to the Bank's capital and funds from the Bank's exposure to scheme liabilities (to the extent liabilities are not met by scheme assets), risks inherent in the valuation of scheme liabilities and assets, risks regarding the split of liabilities between the Bank and other participating employers while the Bank continues to participate in Pace and on exit from Pace.

It is not practicable to provide an estimate of the financial impact of this matter or what effect, if any, that these matters may have upon the Bank's operating revenues, cash flows or financial position in any period.

Tax treatment of separation

Until separation of the Bank from The Co-operative Group is complete, the Bank will continue to be responsible for indemnifying CFSMS under the CFSMS-Bank Services Agreement.

During 2013, the Directors reviewed and reconsidered the accounting treatment of the intangible asset in development and all other assets held on the balance sheet of CFSMS which were used solely by the Bank. The Directors concluded that the Bank was substantially exposed to the risks and rewards of these assets and after considering the funding of the asset and CFSMS's lack of assets to absorb losses, the appropriate accounting treatment would be to hold these assets on the balance sheet of the Bank. The Bank applied a consistent approach to the tax and accounting treatment of the Bank exclusive assets. However, if, and to the extent that, there is a change to this treatment, there may be an additional tax charge. In November 2014 the Bank became the legal owner of the assets held by CFSMS for the provision of services exclusively to the Bank.

There will continue to be VAT charges incurred in respect of any assets that are supplied to the Bank under the CFSMS-Bank Services Agreement that are not owned by the Bank, until separation is fully effected.

Warwick Finance One and Two mortgage securitisation representations and warranties

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

There is a risk that a number of the underlying matters giving rise to the conduct and legal provisions set out in note 32 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.

37. 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, after which, The Co-operative Banking Group, a subsidiary of The Co-operative Group, owned approximately 30% of the Bank. The remaining, approximately 70%, was owned by a number of investors, two of which individually owned more than 10% at the end of 2015. As a result of a further share issue of £400m to existing shareholders in May 2014, The Co-operative Banking Group's share dropped to approximately 20%.

At 31 December 2015, the Bank is an associate of, and therefore a related party of, The Co-operative Group as The Co-operative Group owns 20.16% of the Bank's ordinary shares, has the right to Bank Board representation and there are material transactions between the two companies.

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.

Transactions with The Co-operative Group

Balances owed by The Co-operative Group to the Bank are shown below. In total these balances would exceed the Bank's risk appetite in the normal course of business. These obligations are currently performing in line with expectations and based on investigations and the information provided, therefore the Board considers that impairment is not required. Further details or relationship agreements with The Co-operative Group are shown in the Corporate Governance report.

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).

Good faith discussions have not yet 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. Further information is provided in note 34.

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) which was described in the 2013 Annual report and accounts. In addition, a number of service contracts under the Professional Services Master Agreement have now been terminated and services repatriated to the Bank, with the intention that the majority will be terminated in 2016.

IT separation costs agreement

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. As part of this, the Bank entered into an amendment agreement on 21 December 2015 to the Third Party Access agreement that is in place between the Bank, IBM and The Co-operative Group governing how The Co-operative Group delivers services on behalf of the Bank in the Bank's target IT infrastructure. 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.

Deed of surrender and release – Bank ATMs in Group Food stores

On 1 January 2008 the Bank was granted a licence by CGL to install and operate ATMs at a number of Co-operative Food stores in the UK. On 14 April 2014 CGL served notice on the Bank to terminate this licence with effect from 1 January 2016. As part of a new arrangement between CGL and another third party, on 20 November 2014 CGL and the Bank entered into a deed for the Bank to surrender immediately any rights of occupation it may have in relation to these premises. In consideration for this early surrender, CGL paid to the Bank £2.9m, and a further £5.2m was paid in 2015. The Bank entered into a simultaneous agreement with Cardtronics UK Limited for the sale of these ATMs in CGL premises.

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 into numerous contracts with third party suppliers to replace those previously provided through CFSMS or the wider The Co-operative Group. These activities continued into 2015, in particular in respect of the Bank's transition of enterprise services to IBM.

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 2015 Financial Statements, which include a group relief debtor of £60.1m (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.

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

The Bank's specialist IT security team will continue to provide an IT security service in relation to the IT infrastructure which the Bank and Co-operative Insurance Services General Insurance Limited (CISGIL) share until that infrastructure is separated. This service comprises a small number of people. The Bank has historically provided ad hoc IT security services to The Co-operative Group. Whilst no services are currently being provided, the Bank and The Co-operative Group entered into an agreement to provide a framework for future services on 28 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.

Britannia Pension Scheme

On 23 December 2015 the Bank entered into a deed of Amendment, Cessation, Substitution of Principal Employer, Apportionment, Augmentation and Release (the Deed) relating to the Britannia Pension Scheme with CFSMS and other parties. Under the Deed, the Bank agreed to become Principal Employer and Sponsor of the Britannia Pension Scheme in place of CFSMS with effect from 25 December 2015. In addition, the Bank was released from previous guarantees given in favour of the Scheme Trustees and also for the benefit of the Scheme.

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 of the Bank, and therefore reported them on the balance sheet. 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 that time was £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 31 December 2015 and 31 December 2014 and their location within the Bank's balance sheet.

	2015			
	Loans & advances to customers	**Other assets**	**Customer accounts**	**Other liabilities**
The Co-operative Group Limited	**1.0**	**61.6**	**(100.1)**	**–**
The Co-operative Banking Group Ltd	**–**	**–**	**(0.3)**	**–**
Subsidiaries of The Co-operative Banking Group Ltd	**–**	**19.2**	**(4.6)**	**(6.1)**
	1.0	**80.8**	**(105.0)**	**(6.1)**

	2014			
	Loans & advances to customers	Other assets	Customer accounts	Other liabilities
The Co-operative Group Limited	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)

	2015	2014

	Interest and fees received	**Interest and fees paid**	Interest and fees received	Interest and fees paid
The Co-operative Group Limited	**2.6**	**0.4**	6.3	2.1
The Co-operative Banking Group Ltd	**–**	**–**	–	–
Subsidiaries of The Co-operative Banking Group Ltd	**0.3**	**–**	0.3	–
	2.9	**0.4**	6.6	2.1

A number of transactions are entered into with related parties in the normal course of business on normal commercial terms. These include loans and deposits. Outstanding balances at the year end and related income and expense for the year is presented in the tables above.

Shareholder rights agreement

At the time of the capital raising in May 2014, the Bank entered into a Shareholder Rights Agreement with The Co-operative Group and a number of other investors. As at 31 December 2015, each of The Co-operative Banking Group Limited, SP Coop Investments Limited and Golden Tree Asset Management (via various Golden Tree funds) owns more than 10% of the Bank's ordinary shares and is therefore a related party of the Bank.

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

Transactions with other related parties

Key management personnel, as defined by IAS 24 (Related Party Disclosures), are considered to be the Board of the Bank, and Board members of the Bank's immediate and ultimate holding organisations. The volume of related party transactions with key management is provided below:

Directors, key management personnel and close family members

	2015	2014
Loans outstanding at the beginning of the year	**–**	0.3
Net movement	**–**	(0.3)
Loans outstanding at the end of the year	**–**	**–**
Deposits and investments at the beginning of the year	**0.2**	0.2
Net movement	**0.3**	–
Deposits and investments at the end of the year	**0.5**	0.2

Directors' loans

		2015			2014	
	Mortgages	**Personal loans**	**Credit cards**	Mortgages	Personal loans	Credit cards
Number of Directors with loan type	**–**	**–**	**1**	–	–	–
Total value of Directors' loans	**–**	**–**	**–**	–	–	–

Key management compensation

	2015	2014
Salaries and short term benefits	**4.6**	6.3
Termination benefits	**–**	–

	4.6	6.3

38. Share capital

	2015 No. of shares (millions)	2015 Share capital	2014 No. of shares (millions)	2014 Share capital
Allotted, called up and fully paid (ordinary shares of 5p each)				
At the beginning of the year	**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 year	**451.5**	**22.6**	451.5	22.6
Share premium account				
At the beginning of the year		**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 year		**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 31 December 2015 was 451,456,510 (2014: 451,456,510). The ordinary shareholders have one vote for every share held.

39. 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 31 December 2015							
Assets							
Cash and balances at central banks	**–**	**–**	**2,678.5**	**–**	**–**	**–**	**2,678.5**
Loans and advances to banks	**–**	**–**	**871.0**	**–**	**–**	**–**	**871.0**
Loans and advances to customers	**4.2**	**174.0**	**19,512.2**	**–**	**–**	**–**	**19,690.4**
Fair value adjustments for hedged risk	**–**	**–**	**94.0**	**–**	**–**	**–**	**94.0**
Investment securities	**–**	**582.4**	**15.0**	**4,296.8**	**–**	**–**	**4,894.2**
Derivative financial instruments	**147.9**	**–**	**–**	**–**	**–**	**222.2**	**370.1**
Equity shares	**–**	**–**	**–**	**55.6**	**–**	**–**	**55.6**
Other assets	**–**	**–**	**124.1**	**–**	**–**	**–**	**124.1**
Total financial assets	**152.1**	**756.4**	**23,294.8**	**4,352.4**	**–**	**222.2**	**28,777.9**
Non-financial assets							**250.4**
Total assets							**29,028.3**

Liabilities

Deposits by banks	**–**	**–**	**–**	**–**	**725.9**	**–**	**725.9**
Customer accounts	**–**	**–**	**–**	**–**	**22,732.0**	**–**	**22,732.0**
Customer accounts – capital bonds	**–**	**77.4**	**–**	**–**	**–**	**–**	**77.4**
Debt securities in issue	**–**	**–**	**–**	**–**	**2,554.3**	**–**	**2,554.3**
Derivative financial instruments	**148.1**	**–**	**–**	**–**	**–**	**198.8**	**346.9**
Other borrowed funds	**–**	**–**	**–**	**–**	**459.9**	**–**	**459.9**
Other liabilities	**–**	**–**	**–**	**–**	**68.8**	**–**	**68.8**
Total financial liabilities	**148.1**	**77.4**	**–**	**–**	**26,540.9**	**198.8**	**26,965.2**
Non-financial liabilities							**699.8**
Total liabilities							**27,665.0**
Capital and reserves							**1,363.3**
Total liabilities and equity							**29,028.3**

Whilst the Bank does not hold any derivative financial instruments that are considered ‘derivatives held for trading purposes’ as shown in note 19, IAS 39 requires derivative financial instruments that are not in a hedging relationship to be classified as ‘held for trading’.

Fair value disclosures throughout this note have been calculated in accordance with IFRS 13, which values assets individually rather than as a portfolio.

During 2015, there was a £1.4bn securitisation transaction with Warwick Finance Residential Mortgages Number One PLC and a £1.7bn securitisation transaction with Warwick Finance Residential Mortgages Number Two PLC. For further details please refer to the detailed financial review.

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 principal 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 medium term note programme and also issues certificates of deposit and commercial paper as part of its normal treasury activities.

In addition to this the Bank has issued notes secured by mortgage assets through a number of different securitisation programs.

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 the ALCO, to which authority is delegated by the Board.

b) Valuation of financial assets and liabilities at fair value

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

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

	Fair value at end of the reporting period using:			
	Level 1	**Level 2**	**Level 3**	**Total**
As at 31 December 2015				
Non-derivative financial assets				
Held for trading:				
Loans and advances to customers	**–**	**4.2**	**–**	**4.2**
Designated at fair value:				
Loans and advances to customers	**–**	**168.5**	**5.5**	**174.0**
Investment securities	**582.4**	**–**	**–**	**582.4**
Available for sale financial assets:				
Investment securities	**2,697.0**	**–**	**1,599.8**	**4,296.8**
Equity shares	**0.1**	**4.3**	**51.2**	**55.6**
Derivative financial instruments	**–**	**370.1**	**–**	**370.1**
Non-financial assets				
Investment properties	**–**	**–**	**2.1**	**2.1**
Total assets carried at fair value	**3,279.5**	**547.1**	**1,658.6**	**5,485.2**
Non-derivative financial liabilities				
Designated at fair value:				
Customer accounts – capital bonds	**–**	**77.4**	**–**	**77.4**
Derivative financial instruments	**–**	**346.9**	**–**	**346.9**
Total liabilities carried at fair value	**–**	**424.3**	**–**	**424.3**

	Fair value at end of the reporting period using:			
	Level 1	Level 2	Level 3	Total
As at 31 December 2014				
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 primarily relate to Corporate loans of £159.1m (2014: £164.7m) which are fair valued through profit or loss using observable inputs. Loans held at fair value are valued at the sum of all future expected cash flows, discounted using a yield curve based on observable market inputs.

Investment securities – available for sale

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

Derivative financial instruments

Over-the-counter (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.

Customer accounts – capital bonds

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

Equity shares

Equity shares relate to investments held in VocaLink Holdings Limited and Unity Trust Bank plc, both of which are unquoted shares. For VocaLink, the valuation of these shares is based on the Bank’s percentage shareholding and the net asset value of the consolidated group according to its most recently published financial statements. Following the Bank’s sale of 20.0% shareholding in Unity Trust Bank in December 2015 (see note 6), the sale price has been used to estimate the fair value of the 6.7% retained.

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 £5.5m (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 decreased the valuation by £0.2m in 2015 (2014: £0.5m decrease). A reasonably possible change in the assumptions would not result in any material change in the valuation.

Investment securities – available for sale

Investment securities – available for sale include MBS of £1,599.8m (2014: nil), which are fair valued through other comprehensive income. The Bank uses an independent third party valuation agent which provides prices obtained from large financial institutions. These prices are indicative values only and do not represent an offer to purchase the securities.

The Bank owns a significant portion of the MBS issuance and the trading volume of the remaining portions in the market is not readily available.

These MBS represent the Bank's interest in unconsolidated structured entities.

A 1% increase or decrease in the price of the notes will result in the value increasing or decreasing by approximately £16m respectively.

Equity shares

Equity shares include the Bank's share in Visa Europe Limited, which are classified as available for sale, with any movements in fair value being recognised through other comprehensive income. The fair value of the Visa Europe share has been calculated based on an offer to purchase the Bank's share, which has been accepted, and is expected to complete during 2016. The fair value of the consideration offered has been considered when calculating the fair value of the Visa Europe share.

If the illiquidity premium to the discount rate was assumed to be double (2% instead of 1%), it would result in a reduction in the overall fair value of the equity shares of £2.6m (5%) at 31 December 2015. Therefore, this valuation model is not deemed to be materially sensitive to this input, with a 100% increase resulting in a 5% change in valuation.

Investment properties

Investment properties within level 3 are valued by using the original price, index linked to the balance sheet date using the relevant house price index.

Movements in fair values of instruments with significant unobservable inputs (level 3) were:

	Fair value at the beginning of the year	Purchases and transfers in	Sales, transfers out and repayments	Other Comprehensive Income	Income Statement	Fair value at the end of the year

As at 31 December 2015						
Loans and advances to customers	**6.7**	**–**	**(1.0)**	**–**	**(0.2)**	**5.5**
Derivative assets	**–**	**–**	**–**	**–**	**–**	**–**
Derivative liabilities	**–**	**–**	**–**	**–**	**–**	**–**
Investment securities	**–**	**1,685.5**	**(86.8)**	**1.1**	**–**	**1,599.8**
Equity shares	**–**	**–**	**–**	**51.2**	**–**	**51.2**
Investment properties	**2.1**	**–**	**(0.1)**	**–**	**0.1**	**2.1**
	8.8	**1,685.5**	**(87.9)**	**52.3**	**(0.1)**	**1,658.6**
As at 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 securities	–	–	–	–	–	–
Equity shares	–	–	–	–	–	–
Investment properties	6.2	–	(4.3)	–	0.2	2.1
	(15.8)	–	24.9	–	(0.3)	8.8

c) Fair values of financial assets and liabilities not carried at fair value

The carrying values of financial instruments measured at amortised cost are determined in compliance with the accounting policies in note 1.

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 31 December 2015										
Financial assets										
Loans and advances to banks	**–**	**–**	**871.0**	**871.0**	**–**	**–**	**–**	**–**	**–**	**871.0**
Loans and advances to customers	**14,257.1**	**576.5**	**–**	**14,833.6**	**1,817.3**	**2,861.3**	**4,678.6**	**–**	**–**	**19,512.2**
Fair value adjustments to hedged risk	**98.0**	**–**	**–**	**98.0**	**(4.0)**	**–**	**(4.0)**	**–**	**–**	**94.0**
Investment securities	**–**	**–**	**15.0**	**15.0**	**–**	**–**	**–**	**–**	**–**	**15.0**
Other assets	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**124.1**	**124.1**
Financial liabilities										
Deposits by banks	**–**	**–**	**725.9**	**725.9**	**–**	**–**	**–**	**–**	**–**	**725.9**
Customer accounts	**19,838.7**	**2,682.0**	**–**	**22,520.7**	**211.3**	**–**	**211.3**	**–**	**–**	**22,732.0**
Debt securities in issue	**–**	**–**	**2,554.3**	**2,554.3**	**–**	**–**	**–**	**–**	**–**	**2,554.3**
Other borrowed funds	**–**	**–**	**459.9**	**459.9**	**–**	**–**	**–**	**–**	**–**	**459.9**
Other liabilities	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**68.8**	**68.8**

	Core				Non-core					
Fair Value	**Retail**	**BaCB**	**Treasury**	**Total Core**	**Corporate CoAM**	**Optimum**	**Total Non-core**	**Unity Trust**	**Unallocated & Statutory**	**Total**

								Bank	Adjustments	
As at 31 December 2015										
Financial assets										
Loans and advances to banks	**–**	**–**	**871.0**	**871.0**	**–**	**–**	**–**	**–**	**–**	**871.0**
Loans and advances to customers	**14,429.3**	**559.5**	**–**	**14,988.8**	**1,659.4**	**2,556.6**	**4,216.0**	**–**	**–**	**19,204.8**
Fair value adjustments to hedged risk	**98.0**	**–**	**–**	**98.0**	**(4.0)**	**–**	**(4.0)**	**–**	**–**	**94.0**
Investment securities	**–**	**–**	**13.3**	**13.3**	**–**	**–**	**–**	**–**	**–**	**13.3**
Other assets	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**124.1**	**124.1**
Financial liabilities										
Deposits by banks	**–**	**–**	**725.9**	**725.9**	**–**	**–**	**–**	**–**	**–**	**725.9**
Customer accounts	**19,842.2**	**2,683.5**	**–**	**22,525.7**	**211.3**	**–**	**211.3**	**–**	**–**	**22,737.0**
Debt securities in issue	**–**	**–**	**2,882.7**	**2,882.7**	**–**	**–**	**–**	**–**	**–**	**2,882.7**
Other borrowed funds	**–**	**–**	**498.7**	**498.7**	**–**	**–**	**–**	**–**	**–**	**498.7**
Other liabilities	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**68.8**	**68.8**

	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

	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	747.6	–	29,625.6
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 in total is 98% of the carrying value as at 31 December 2015. The overall fair value is less than par primarily due to two main factors for Non-core loans in particular:

1. Customer interest rates are below the market rate for the period until expected maturity or the repricing date, if earlier; and

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

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.

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 year 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 five 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.

Investment securities

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

Customer accounts

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

Debt securities in issue and other borrowed funds

The aggregate fair values calculated based on quoted market prices. 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 above the carrying value as a result of the carrying value being net of merger fair value adjustments. The carrying values of debt securities in issue are expected to increase as the merger fair value adjustments continue to unwind, as shown in the following section.

Unwind of merger fair value adjustments

On the merger of the Bank and Britannia Building Society in August 2009 an exercise was undertaken to fair value the respective assets and liabilities of Britannia Building Society. These fair value adjustments are unwound on an EIR basis over the estimated behavioural lives of the assets and liabilities. As at 31 December 2015 the remaining merger fair value unwinds and the forecast unwind profiles can be summarised as follows:

	Carrying amount at year end	Remaining merger fair value to be unwound at year end	Actual unwind for the year to 31 December 2015	Forecast unwind			
				2016	2017	2018	2019+
As at 31 December 2015							
Assets							
Loans and advances to customers	**19,690.4**	**(21.6)**	**(20.1)**	**(2.3)**	**(2.1)**	**(1.9)**	**(15.3)**
Fair value adjustment for hedged risk	**94.0**	**(9.8)**	**(13.5)**	**(1.9)**	**(1.8)**	**(1.4)**	**(4.7)**
Other	**9,243.9**	**20.5**	**5.9**	**4.4**	**4.4**	**4.4**	**7.3**
Total assets	**29,028.3**	**(10.9)**	**(27.7)**	**0.2**	**0.5**	**1.1**	**(12.7)**
Liabilities							
Debt securities in issue	**2,554.3**	**(235.1)**	**(143.5)**	**(176.9)**	**(58.2)**	**–**	**–**
Deferred tax liabilities	**47.8**	**44.9**	**31.5**	**35.5**	**11.4**	**(0.4)**	**(1.6)**
Other	**25,062.9**	**–**	**–**	**–**	**–**	**–**	**–**
Total liabilities	**27,665.0**	**(190.2)**	**(112.0)**	**(141.4)**	**(46.8)**	**(0.4)**	**(1.6)**

Included in the actual unwind for the year to 31 December 2015 for loans and advances to customers is an amount of £17.4m relating to the two securitisation transactions with Warwick Finance Residential Mortgages Number One PLC and Warwick Finance Residential Mortgages Number Two PLC.

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

Issue name	Issue date	Contractual maturity date	Carrying amount at year end	Fair value at year end	Remaining merger fair value to be unwound at year end	Actual unwind for the year to 31 December 2015	Forecast unwind 2016	2017	2018
As at 31 December 2015									
Leek Finance Number Seventeen plc	April 2006	June 2016	**536.0**	**548.7**	**29.5**	**47.5**	**29.5**	**–**	**–**
Leek Finance Number Eighteen plc	October 2006	December 2016	**687.3**	**698.5**	**72.0**	**51.4**	**72.0**	**–**	**–**
Leek Finance Number Nineteen plc	April 2007	June 2017	**676.1**	**681.2**	**137.0**	**49.7**	**78.1**	**58.9**	**–**
Total Leek Notes			**1,899.4**	**1,928.4**	**238.5**	**148.6**	**179.6**	**58.9**	**–**

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

Issue name	Carrying amount at year end	Fair value at year end	Remaining merger fair value to be unwound at year end	Actual unwind for the year to 31 December 2015	Forecast unwind 2016	2017	2018
As at 31 December 2015							
Internally Held Leek Notes	537.7	527.3	3.4	5.1	2.7	0.7	–

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

Fair values are determined according to the hierarchy set out above.

	Carrying value	Level 1	Level 2	Level 3
As at 31 December 2015				
Financial assets				
Loans and advances to banks	**871.0**	**–**	**871.0**	**–**
Loans and advances to customers	**19,512.2**	**–**	**–**	**19,204.8**
Fair value adjustment for hedged risk	**94.0**	**–**	**–**	**94.0**
Investment securities	**15.0**	**13.3**	**–**	**–**
Financial liabilities				
Deposits by banks	**725.9**	**–**	**725.9**	**–**
Customer accounts	**22,732.0**	**–**	**22,737.0**	**–**
Debt securities in issue	**2,554.3**	**401.2**	**2,481.5**	**–**
Other borrowed funds	**459.9**	**–**	**498.7**	**–**

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

	Carrying value	Level 1	Level 2	Level 3
As at 31 December 2014				
Financial assets				
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				
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	–

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 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 Bank.

	Carrying amount of transferred assets not derecognised	Carrying amount of associated liabilities	Fair value of transferred assets not derecognised	Fair value of associated liabilities	Net fair value position
As at 31 December 2015					
Leek Finance Number Seventeen plc	**525.1**	**536.0**	**497.1**	**548.7**	**(51.6)**
Leek Finance Number Eighteen plc	**633.3**	**687.3**	**615.4**	**698.5**	**(83.1)**
Leek Finance Number Nineteen plc	**617.0**	**676.1**	**600.0**	**681.2**	**(81.2)**
Leek Finance Number Twenty plc[1]	**–**	**–**	**–**	**–**	**–**
Leek Finance Number Twenty One plc[1]	**–**	**–**	**–**	**–**	**–**
Leek Finance Number Twenty Two plc[1]	**–**	**–**	**–**	**–**	**–**
Silk Road Finance Number One plc[1]	**–**	**–**	**–**	**–**	**–**
Silk Road Finance Number Three plc	**343.9**	**351.2**	**342.7**	**350.6**	**(7.9)**
Cambric Finance Number One plc[1]	**–**	**–**	**–**	**–**	**–**
Meerbrook Finance Number Eight Ltd	**377.7**	**364.0**	**379.5**	**366.6**	**12.9**
	2,497.0	**2,614.6**	**2,434.7**	**2,645.6**	**(210.9)**

1. These companies were liquidated during the year.

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	**2,614.6**
Internally held fixed and floating rate notes	**(645.7)**
Loan facilities and subdebt not included in debt securities in issue	**(311.9)**
Non securitised debt securities	**1,122.6**
Merger fair value adjustment	**(244.8)**
Other adjustments	**19.5**
Debt securities in issue per financial liabilities	**2,554.3**

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 31 December 2015					
Leek Finance Number Seventeen plc	**149.8**	**152.9**	**156.5**	**151.6**	**4.9**
Leek Finance Number Eighteen plc	**175.8**	**190.8**	**193.9**	**186.7**	**7.2**
Leek Finance Number Nineteen plc	**177.0**	**194.0**	**195.5**	**189.0**	**6.5**
Silk Road Finance Number Three plc	**105.8**	**108.0**	**105.4**	**106.3**	**(0.9)**
	608.4	**645.7**	**651.3**	**633.6**	**17.7**

The above carrying value and fair value of assets held for each entity has been determined by applying the proportion of internally held liabilities.

Transferred assets include securitised gilts and loans and advances to customers that have not been derecognised by the seller. The associated liabilities include the fixed and floating rate notes, bank loans and intercompany loans that specifically relate to the funding for the assets securitised.

The difference between the fair value and carrying value of the mortgages that have been securitised within Leek 17, 18 and 19 is 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 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 transferred assets not derecognised (restated)[1]	Fair value of associated liabilities	Net fair value position
As at 31 December 2014					
Leek Finance Number Seventeen plc	554.0	581.5	546.1	585.9	(39.8)
Leek Finance Number Eighteen plc	662.9	724.2	660.8	722.9	(62.1)

Leek Finance Number Nineteen plc	642.9	712.8	644.2	710.9	(66.7)
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 Ltd	564.5	564.5	570.3	458.2	112.1
	7,339.8	7,541.9	7,484.1	7,280.3	203.8

1. The 2014 comparative fair value of transferred assets not derecognised and resultant net fair value position has been recalculated to bring these in line with the methodology used in 2015.

Covered Bond Limited Liability Partnerships

Moorland Covered Bonds LLP was established as a result of a £1.4bn covered bond retained issuance. Loans and advances to customers of £1.9bn were transferred to Moorland Covered Bonds LLP. The transfer was funded by a loan of £1.4bn and capital contribution of £0.5bn. During October 2011 the £1.4bn loan was repaid. Following additional capital contribution repayment and on achieving Regulated Covered Bond status there was a public issuance of notes in November 2011 totalling £0.6bn. At the period end the Bank held a loan of £0.6bn (2014: £0.6bn) and a capital contribution of £0.6bn (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 Bank's accounts. The table below shows the carrying values and fair values of the assets transferred to the covered bond and their associated liabilities:

	Carrying amount of transferred loans and advances to customers	Carrying amount of fixed and floating rate notes	Fair value of transferred loans and advances to customers	Fair value of fixed and floating rate notes	Net fair value position
As at 31 December 2015					
Moorland Covered Bonds LLP	**1,215.4**	**596.9**	**1,222.6**	**668.1**	**554.5**
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 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 31 December 2015					
Investment securities sold under repurchase agreements	**721.7**	**671.2**	**721.7**	**671.2**	**50.5**
As at 31 December 2014					
Investment securities sold under	–	–	–	–	–

repurchase agreements

Associated liabilities are included within deposits by banks.

Assets sold under repurchase agreements include mortgage backed securities (£204.7m of assets and associated liabilities of £159.6m) and UK government gilts (£517.0m of assets and associated liabilities of £511.6m).

42. Post balance sheet events

It is a requirement of IAS 10 (Events after the balance sheet date) that these financial statements reflect events arising after 31 December 2015. The following events have occurred between 31 December 2015 and 31 March 2016 (the date of approval of these financial statements) and represent 'non adjusting' post balance sheet events:

Acquisition of Britannia Pension Trustees Limited

On 17 March 2016 the Bank acquired 100% of the issued share capital of Britannia Pension Trustees Limited from The Co-operative Banking Group Limited for consideration of £1.

Britannia Pension Trustees Limited is the sole trustee of the Britannia Pension Scheme and does not operate any trading activity.

Branch Closures

Board approval for the closure of an additional 54 branches during 2016 was obtained in December 2015 as part of the ongoing simplification and cost reduction scheme and in response to a 29% year on year reduction in branch transactions.

Communications of the closures to customers began in January 2016 and expect to be concluded by the end of March 2016. The impact of the closures to the Bank will be the recognition of a £8.7m provision relating to closure costs.