Nick Slape (CEO) and Louise Britnell (CFO) will host a video conference on 01 March 2023 at 9am (UK time) to present the full year 2022 results followed by a Q&A session.

To access the call please visit https://www.co-operativebank.co.uk/about-us/investor-relations/

Additional materials are also available at this address.

BASIS OF PRESENTATION

The Co-operative Bank Holdings Limited is the immediate parent company of The Co-operative Bank Finance p.l.c. and the ultimate parent company of The Co-operative Bank p.l.c. In the following pages the term 'Group' refers to The Co-operative Bank Holdings Limited and its subsidiaries. The term 'Finance Group' refers to The Co-operative Bank Finance p.l.c. and its subsidiaries. The term 'Bank' refers to The Co-operative Bank p.l.c. and its subsidiaries which are consolidated within the Finance Group and then ultimately the Group. Unless otherwise stated, information presented for the Group equally applies to the Bank and the Finance Group.

Underlying basis: The statutory results are adjusted to remove certain items that do not promote an understanding of historical or future trends of earnings or cash flows, which therefore allows a more meaningful comparison of the Group's underlying performance.
Alternative performance measures: The Group uses a number of alternative performance measures, including underlying profit or loss, in the discussion of its business performance and financial position.

2022 Annual Report and Accounts

01 March 2023

The Co-operative Bank ('the Bank') is pleased to provide an update on its performance in the twelve months ended 31 December 2022:

- **Profit before tax of £132.6m and underlying profit of £136.0m;** an increase of £101.5m and £95.0m vs FY 21
- **Low cost funding model on a secured balance sheet;** a low level of arrears across a high quality mortgage portfolio
- **De-risking of Pace pension scheme;** the Pace Trustee completed a full "buy-in" of the Bank section of Pace
- **Strong capital underpinning financial performance;** significant opportunity for capital optimisation
- **Market leader in ESG;** 'most ethical Bank UK 2022' awarded by Capital Finance International (CFI), and market leading Sustainalytics ratings
- **Delivered our 2022 commitments;** positive momentum as we move into 2023

Nick Slape, Chief Executive Officer, said:

"I am extremely proud of what we have achieved during our 150th year. The Bank has not only delivered a significant improvement in profitability to £132.6m (FY 21: £31.1m), but has also achieved several notable milestones, such as the successful issuance of £250m of senior unsecured debt in March 2022, full compliance with its capital requirements including all buffers one year ahead of plan and the de-risking of the Pace defined benefit pension scheme.

Our IT simplification programme is progressing well with the successful launch of two new savings products, with the final one due to launch in Q1, which will complete the re-platforming of the savings books. We will fully in-house our mortgage servicing capabilities by the first quarter of this year.

While the macro-economic environment remains challenging, we continue to work hard to ensure that both our customers and colleagues feel supported.

Looking to the future, we are focussed on delivering both growth and attractive, sustainable returns for our shareholders. Our capital position gives us the scope for optimisation as well as continued investment in our group and returns of capital to shareholders.

I would like to take the opportunity again to thank our colleagues and customers for their support."

FINANCIAL PERFORMANCE UPDATE

INCOME STATEMENT (£m)

	12 months ended 31 December	
	2022	**2021**
Net interest income	**458.3**	323.9
Other operating income	**41.1**	37.6
Total income	**499.4**	361.5
Operating expenditure	**(372.7)**	(346.1)
Impairment	**(6.4)**	(1.1)
Non-operating income	**12.3**	16.8
Profit before tax	**132.6**	31.1
Taxation	**(110.5)**	166.2
Profit after tax	**22.1**	197.3
Adjustments to profit before tax		
Exceptional project expenditure	**12.4**	28.8
Other exceptional (gains)	**(9.0)**	(18.9)
Underlying profit before tax	**136.0**	41.0
Key ratios:		
Net interest margin (bps) [1]	**166**	125
Adjusted RoTE (%) [2]	**13.7**	4.7
Cost:income ratio (%) [3]	**72.8**	91.5
Asset quality ratio (bps) [4]	**3.1**	0.5

1. Annualised net interest income over average interest earning assets
2. Underlying profit minus current tax over CET1 resources
3. Total statutory expenditure over total statutory income (excludes impairment)
4. Annualised impairment charge over average customer assets

PERFORMANCE HIGHLIGHTS

Profit before tax of £132.6m and underlying profit of £136.0m

Total income, which includes net interest income and other operating income, has increased by 38% in comparison to the twelve months ended 31 December 2021 to £499.4m (FY 21: £361.5m).

Net interest income has increased by 41% to £458.3m (FY 21: £323.9m) and net interest margin (NIM) has increased by 41 basis points (bps) from 125bps to 166bps, reflecting improving deposit margins following increases in the base rate to 3.5%.

Operating expenditure has increased by 8% to £372.7m (FY 21: £346.1m), reflecting higher staff costs following actions taken by the Bank to support colleagues with the rising cost of living and the impact of recruitment within our call centres. Non-staff costs have increased by £14.5m (7.3%) to £214.5m following higher marketing spend in 2022, a higher rate of fraud and 2021 benefits relating to releases of provisions for branch closures and PPI.

Project costs of £37.8m (FY 21: £38.1m) were driven primarily by the mortgage and savings systems simplification programme. Our statutory cost:income ratio has improved in the period to 72.8% from 91.5%, due to the actions taken to grow income outweighing the acceleration of the transformation spend and inflationary pressures.

Net impairment charge of £6.4m (FY 21: £1.1m) reflects a deterioration in the Bank's macro-economic forecasts along with adjustments for affordability across secured and unsecured portfolios as a result of cost of living pressures. This is partially offset by the net impact of Covid provision releases and reflects the ongoing monitoring of customer arrears data in the post-pandemic period.

We have reported a £12.3m non-operating exceptional gain (FY 21: £16.8m) which includes the profit on sale of a small legacy loan book in the first quarter of the year, as well as the revaluation and partial sale of our Visa shareholding.

Income tax charge of £110.5m

The Group's continuing profitability has resulted in a current tax charge of £5.7m (2021: £nil) and confidence in sustainable future profits has allowed the Group to recognise further deferred tax assets to shelter future taxable profits.

The pension "buy-in" has resulted in a reduction in deferred tax liabilities (£110.6m) which has led to a decrease in the offsetting deferred tax assets and a charge to the income statement of £58.4m

The UK rate of corporation tax will increase from 19% to 25% with effect from 1 April 2023 and because this legislative change had been enacted, the increase was reflected in the Group's deferred tax balances at 31 December 2021. In February 2022, further legislation was enacted to reduce the banking surcharge from 8% to 3%, and to increase the threshold below which it is not chargeable to £100m (previously £25m) from 1 April 2023. The impact is a reduction in the value of deferred tax assets, and a £43.3m charge to the income statement.

Low cost funding model on a secured balance sheet

Total assets have reduced by 4% compared with 31 December 2021 with legacy assets reducing by 13% to £0.6bn. Retail secured balances have only increased slightly to £19.6bn as we have actively managed new business volumes to preserve Bank margins. Mortgage pipeline is c.£1.7bn (FY 21: £1.2bn).

Total liabilities have reduced by 3% to £26.8bn over the period (FY 21: £27.6bn). Customer deposit balances across both retail and SME segments have reduced to £20.0bn (FY 21: £21.1bn), following some marginal unwind of excess balances built up over the pandemic. The Bank maintains a very strong LCR position of 265.3%.

The asset quality ratio (AQR) in total across retail, SME and legacy customer lending remains low, reflecting the Bank's low-risk lending profile. AQR for the Bank as a whole as at 31 December 2022 reflects a charge of 3.1bps (FY 21: 0.5bps). The average core mortgage book loan-to-value (LTV) remains low at 53.5% (FY 21: 56.8%). Secured accounts that are greater than three months in arrears represented 0.13% of total accounts as at 31 December 2022 (FY 21: 0.13%).

De-risking of Pace pension scheme

Pace, the pension trustee, has completed a full "buy-in" transaction of the Bank Section, through which a bulk annuity insurance policy has been purchased, covering all liabilities required to meet future defined benefit pensions for the Bank Section and delivering greater security to its members. The insurance policy was purchased using existing assets held within Bank Section, without the need for the Bank to make any additional contributions. The impact is capital neutral as the related amounts were previously deducted via regulatory adjustments.

The Bank views the "buy-in" as a positive development and is supportive of the Trustee's approach, which aligns to the Bank's own strategic objectives through elimination of the primary investment and longevity risks that the Bank Section is exposed to.

Strong capital underpinning financial performance

CET1 ratio has reduced from 20.7% to 19.8% and remains well above the regulatory minimum of 13.3%. CET1 ratio reduction is driven by the impact of regulatory adjustments for PS11/20 and software intangibles. PS11/20 covers changes to the modelling of secured credit risk, in particular in relation to the assessment of probability of default and loss given default, with an implementation date of 1 January 2022. Organic CET1 ratio generation year-to-date totals 350bps before the impact of the regulatory adjustments, reflecting profit for the period.

Total MREL-qualifying resources have grown by £290.4m, predominantly due to the successful £250m MREL issuance under our inaugural Green, Social and Sustainability Framework, which was completed in April 2022. Based on an implied end-state requirement (using the FY 22 reported balance sheet) of 29.6% including CRD IV buffers, we have surplus MREL resources.

Risk-weighted assets (RWAs) totalled £4.8bn (FY 21: £4.4bn). With a stable balance sheet the majority of the movement is a result of the impact of regulatory adjustments for PS11/20.

We are now fully compliant with capital requirements plus all buffers on a sustainable basis one year ahead of schedule. This is the first time the Bank has been sustainably capital compliant since 2013 and represents a significant landmark in terms of the Bank's future resilience and stability.

Market leader in ESG

Environmental and social issues have always mattered to us and because we embed this throughout all of our corporate governance, we have been recognised as the UK's best ESG-rated high street bank with a market-leading score of 8.3 from Sustainalytics, a leading independent provider of ESG and corporate governance ratings. We were also pleased to be recognised by other ESG agencies such as MSCI who rated us AAA which was upgraded from A in 2021. In addition, we announced in the fourth quarter that we have been awarded the Most Ethical Bank – UK 2022 by CFI.

Earlier in the year we announced the sixth iteration of our customer-led Ethical Policy which has been in place for 30 years. More information can be found on our website via the following link https://www.co-operativebank.co.uk/values-and-ethics/. This refreshed policy is shaped by c.50,000 responses to our recent Value and Ethics Poll and guides how we do business.

We've been operationally beyond net carbon neutral for 15 years and have both continued to send zero waste to landfill, and increased the amount of waste we recycle. We remain committed to tackling the climate-nature emergency and are proud industry ambassadors of Zero Hour, the campaign for the Climate and Ecological Bill.

We have also launched one of the biggest, boldest, most disruptive brand campaigns in our history – "The Bank you can hold to account" as we look to highlight to consumers the difference that they can make to the world simply through who they bank with. With values and ethics at our core and a refreshed and unique customer-led Ethical Policy, we are committed to using our customers' money to do good for the planet, people and communities.

Outlook

During 2022 we delivered improved financial performance and continued to invest in the Bank. Our financial outlook for 2023 is as follows:

- Bank net interest margin of approximately 180bps; reflecting additional base rate rises driving margin widening.
- Total statutory costs of approximately £420m; further investment in our brand and systems alongside inflationary pressures.
- Asset quality ratio of less than 5bps; arrears remain low and stable across all portfolios.
- Customer assets of c.£22bn; margin improvement during 2023.
- Return on tangible equity of approximately 10%; profitability and improved performance drives shareholder value.
- Our new capital management framework including dividend policy will enable a more efficient level of capital resources and allow us to make the required investment in our business to grow and provide capital returns to our shareholders over the long term.

SEGMENTAL PROFIT/(LOSS) (£m)

2022	**Core**			**Legacy &**	**Group**
	Retail	**SME**	**Total**	**unallocated**	
Net interest income	397.0	69.3	**466.3**	(8.0)	**458.3**
Other operating income	22.7	18.7	**41.4**	(0.3)	**41.1**
Operating income/(expense)	**419.7**	**88.0**	**507.7**	**(8.3)**	**499.4**
Operating expenses	(288.6)	(63.6)	**(352.2)**	(20.5)	**(372.7)**
Net credit impairment gains/(losses)	(5.2)	(1.6)	**(6.8)**	0.4	**(6.4)**
Non-operating income	-	-	**-**	12.3	**12.3**
Profit before tax	**125.9**	**22.8**	**148.7**	**(16.1)**	**132.6**

2021	**Core**			**Legacy &**	**Group**
Re-presented	**Retail**	**SME**	**Total**	**unallocated**	
Net interest income	284.8	47.4	**332.2**	(8.3)	**323.9**
Other operating income	20.3	16.5	**36.8**	0.8	**37.6**
Operating income/(expense)	**305.1**	**63.9**	**369.0**	**(7.5)**	**361.5**
Operating expenses	(259.8)	(55.1)	**(314.9)**	(31.2)	**(346.1)**
Net credit impairment gains/(losses)	0.9	(1.1)	**(0.2)**	(0.9)	**(1.1)**
Non-operating income	-	-	**-**	16.8	**16.8**
Profit before tax	**46.2**	**7.7**	**53.9**	**(22.8)**	**31.1**

SEGMENTAL ASSETS AND LIABILITIES (£m)

31 December 2022	Core Retail	Core SME	Core Total	Legacy & unallocated	Group
Assets	19,841.3	388.2	**20,229.5**	7,903.3	**28,132.8**
Liabilities	16,607.8	3,396.8	**20,004.6**	6,829.2	**26,833.8**

31 December 2021	Core Retail	Core SME	Core Total	Legacy & unallocated	Group
Assets	19,756.0	441.7	20,197.7	9,125.6	29,323.3
Liabilities	17,604.4	3,461.0	21,065.4	6,506.0	27,571.4

SELECTED KEY PERFORMANCE INDICATORS

% (unless otherwise stated)	2022	2021	Change
CET1 ratio	**19.8**	20.7	(0.9)
Total capital ratio	**23.8**	25.4	(1.6)
Risk-weighted assets (£m)	**4,816**	4,373	443
Leverage ratio (PRA) [1]	**4.0**	3.8	0.2
Liquidity coverage ratio [2]	**265.3**	205.3	60.0
Loan to deposit ratio	**104.1**	99.1	5.0
Average core mortgage LTV	**53.5**	56.8	(3.3)
Core mortgage accounts > 3 months in arrears (volume)	**0.13**	0.13	0.0
NPL as a % of total exposures	**0.4**	0.3	0.1

1. Calculated as per PRA definition, excluding Bank of England reserves
2. Calculated in line with Pillar 3 requirements based on a rolling 12 month average

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The person responsible for arranging the release of this announcement on behalf of The Co-operative Bank Finance p.l.c and The Co-operative Bank p.l.c. is Catherine Green, Company Secretary.

About The Co-operative Bank
The Co-operative Bank p.l.c. provides a range of banking products and services to about 2.7m retail customers and c.94k small and medium sized enterprises ('SME'). The Bank is committed to values and ethics in line with the principles of the co-operative movement. The Co-operative Bank is the only high street bank with a customer-led ethical policy, which gives customers a say in how their money is used. Launched in 1992, the policy has been updated on six occasions, with new commitments added in June 2022 to cover what we do for our planet, people and the community.

The Co-operative Bank p.l.c. is authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority. The Co-operative Bank p.l.c. eligible customers are protected by the Financial Services Compensation Scheme in the UK, in accordance with its terms.

Note: This announcement contains inside information.
The Co-operative Bank p.l.c. LEI: 213800TLZ6PCLYPSR448
The Co-operative Bank Finance p.l.c. LEI: 213800KNE8ER4N9BLF11

PRIMARY FINANCIAL STATEMENTS

CONSOLIDATED INCOME STATEMENT

£million

	Year ended 31 December	
	2022	**2021**
Interest income calculated using the effective interest rate method	**581.2**	422.7
Other interest and similar income	**88.7**	11.2
Interest income and similar income	**669.9**	433.9
Interest expense and similar charges	**(211.6)**	(110.0)
Net interest income	**458.3**	323.9
Fee and commission income	**64.4**	58.4
Fee and commission expense	**(32.6)**	(33.2)
Net fee and commission income	**31.8**	25.2
Income from investments	**0.2**	0.3
Other operating income (net)	**21.4**	28.9
Operating income	**511.7**	378.3
Operating expenses	**(373.7)**	(348.7)
Net customer redress release	**1.0**	2.6
Total operating expenses	**(372.7)**	(346.1)
Operating profit before net credit impairment losses	**139.0**	32.2
Net credit impairment losses	**(6.4)**	(1.1)
Profit before tax	**132.6**	31.1
Income tax	**(110.5)**	166.2
Profit for the financial year	**22.1**	197.3

The results above are for the consolidated Group and Bank and wholly relate to continuing activities. More information regarding the basis of preparation can be found in the Annual Report and Accounts, which have been made available on our website.

The profit for the financial year is wholly attributable to equity shareholders.

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

£million

	Year ended 31 December	
	2022	**2021**
Profit for the financial year	**22.1**	197.3
Items that may be recycled to profit or loss:		
Changes in cash flow hedges:		
Transfers from equity to income or expense	**(6.9)**	(9.2)
Income tax	**2.8**	1.4
Changes in fair value through other comprehensive income:		
Net changes in fair value recognised directly in equity	**121.6**	30.6
Transfers from equity to income or expense	**(131.3)**	(32.8)
Income tax	**1.5**	0.3
Items that may not subsequently be recycled to profit or loss:		
Changes in net retirement benefit asset:		
Defined benefit plans (losses)/gains for the year	**(693.8)**	182.7
Income tax	**231.1**	(92.8)
Other comprehensive (expense)/income for the financial year, net of income tax	**(475.0)**	80.2
Total comprehensive (expense)/income for the financial year	**(452.9)**	277.5

The results above are for the consolidated Group and Bank. More information regarding the basis of preparation can be found in the Annual Report and Accounts, which have been made available on our website.

CONSOLIDATED BALANCE SHEET

£million

	31 December 2022	31 December 2021
Assets		
Cash and balances at central banks	**5,270.4**	5,696.9
Loans and advances to banks	**387.1**	191.5
Loans and advances to customers	**20,921.9**	21,002.1
Fair value adjustments for hedged risk	**(430.7)**	(90.5)
Investment securities	**942.7**	1,201.4
Derivative financial instruments	**520.1**	248.5
Equity shares	**11.1**	22.8
Other assets	**14.1**	12.7
Prepayments	**21.4**	20.3
Property, plant and equipment	**22.8**	24.3
Intangible assets	**90.0**	68.5
Right-of-use assets	**33.0**	46.9
Current tax assets	**1.8**	-
Deferred tax assets	**167.4**	36.8
Net retirement benefit asset	**159.7**	841.1
Total assets	**28,132.8**	29,323.3

Liabilities		
Deposits by banks	**5,683.4**	5,527.6
Customer accounts	**20,107.3**	21,135.9
Fair value adjustment for hedged risk	**(34.6)**	(7.5)
Debt securities in issue	**181.9**	203.3
Derivative financial instruments	**103.5**	148.2
Other liabilities	**42.8**	38.7
Accruals and deferred income	**32.5**	37.0
Provisions	**33.2**	33.9
Other borrowed funds	**646.9**	402.1
Lease liabilities	**31.0**	44.1
Net retirement benefit liability	**5.9**	8.1
Total liabilities	**26,833.8**	27,571.4

Capital and reserves attributable to the Group's equity holders		
Ordinary share capital	**0.9**	0.9
Share premium account	**313.8**	313.8
Retained earnings	**1,968.1**	1,946.0
Other reserves	**(983.8)**	(508.8)
Total equity	**1,299.0**	1,751.9
Total liabilities and equity	**28,132.8**	29,323.3

The financial positions above are for the consolidated Group and Bank. More information regarding the basis of preparation can be found in the Annual Report and Accounts, which have been made available on our website.

CONSOLIDATED STATEMENT OF CASH FLOWS

£million

	Year ended 31 December	
	2022	**2021**
Cash flows (used in)/from operating activities:		
Profit before tax	**132.6**	31.1
Adjustments for non cash movements:		
Pension scheme adjustments	**(12.7)**	(5.6)
Net credit impairment losses	**6.4**	1.1
Depreciation, amortisation and impairment	**35.3**	36.6
Other non-cash movements including exchange rate movements	**135.6**	121.5
Changes in operating assets and liabilities:		
Increase in deposits by banks	**155.8**	3,461.2
Increase in prepayments	**(1.1)**	(7.1)
(Decrease)/increase in accruals and deferred income	**(4.5)**	2.0
(Decrease)/increase in customer accounts	**(1,028.8)**	769.2
Decrease in debt securities in issue	**(21.4)**	(525.5)
(Increase)/decrease in loans and advances to banks	**(28.5)**	13.6
Decrease/(increase) in loans and advances to customers	**32.5**	(2,356.6)
Net movement of other assets and other liabilities	**(28.6)**	118.0
Income tax paid	**(6.8)**	-
Net cash flows (used in)from operating activities	**(634.2)**	1,659.5
Cash flows from/(used) investing activities:		
Purchase of tangible and intangible assets	**(48.0)**	(28.9)
Purchase of investment securities	**(465.7)**	(873.2)
Proceeds from sale of property and equipment	**0.4**	1.9
Proceeds from sale of shares and other interests	**20.4**	2.0
Proceeds from sale and maturity of investment securities	**679.0**	774.9
Purchase of equity shares	**(0.8)**	(0.5)
Dividends received	**0.2**	0.3
Net cash flows from/(used) investing activities	**185.5**	(123.5)
Cash flows from/(used in) financing activities:		
Proceeds from MREL issuance	**248.4**	-
Interest paid on Tier 2 notes and senior unsecured debt	**(44.5)**	(37.0)
Lease liability principal payments	**(14.6)**	(11.0)
Net cash flows from/(used in) financing activities	**189.3**	(48.0)
Net (decrease)/increase in cash and cash equivalents	**(259.4)**	1,488.0
Cash and cash equivalents at the beginning of the year	**5,717.5**	4,229.5
Cash and cash equivalents at the end of the year	**5,458.1**	5,717.5
Comprising of:		
Cash and balances with central banks	**5,183.8**	5,609.8
Loans and advances to banks	**274.3**	107.7
	5,458.1	5,717.5

RECONCILIATION OF MOVEMENTS OF LIABILITIES TO CASHFLOWS ARISING FROM FINANCING ACTIVITIES

£million

	2022			2021		
	Lease liabilities	Other borrowed funds	Total	Lease liabilities	Other borrowed funds	Total
Balance at the beginning of the year	44.1	402.1	**446.2**	53.6	408.2	461.8
Changes from financing cashflows						
Proceeds from MREL issuance	-	248.4	**248.4**	-	-	-
Interest paid on Tier 2 notes and senior unsecured debt	-	(44.5)	**(44.5)**	-	(37.0)	(37.0)
Lease liability principal payments	(14.6)	-	**(14.6)**	(11.0)	-	(11.0)
Total changes from financing cash flows	**29.5**	**606.0**	**635.5**	42.6	371.2	413.8
Other changes						
Interest payable on lease liabilities and Tier 2 notes	1.2	48.1	**49.3**	1.7	37.0	38.7
Other non cash movement	-	(7.2)	**(7.2)**	-	(6.1)	(6.1)
Remeasurements/(derecognition) of lease liabilities	0.3	-	**0.3**	(0.2)	-	(0.2)
Balance at the end of the year	31.0	646.9	**677.9**	44.1	402.1	446.2

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

£million

2022	**Share capital**	**Share premium**	**FVOCI reserve**	**Cash flow hedging reserve**	**Capital redemption reserve**	**Capital re-organisation reserve**	**Defined benefit pension reserve**	**Retained earnings**	**Total equity**
At 1 January 2022	0.9	313.8	2.9	14.7	-	(1,011.4)	485.0	1,946.0	1,751.9
Total comprehensive (expense)/income for the year	-	-	(8.2)	(4.1)	-	-	(462.7)	22.1	(452.9)
At 31 December 2022	**0.9**	**313.8**	**(5.3)**	**10.6**	**-**	**(1,011.4)**	**22.3**	**1,968.1**	**1,299.0**

2021	**Share capital**	**Share premium**	**FVOCI reserve**	**Cash flow hedging reserve**	**Capital redemption reserve**	**Capital re-organisation reserve**	**Defined benefit pension reserve**	**Retained earnings**	**Total equity**
At 1 January 2021	0.9	313.8	4.8	22.5	410.0	1,737.5	395.1	(1,410.2)	1,474.4
Total comprehensive (expense)/income for the year	-	-	(1.9)	(7.8)	-	-	89.9	197.3	277.5
Reserve reorganisation [1]	-	-	-	-	(410.0)	(2,748.9)	-	3,158.9	-
At 31 December 2021	0.9	313.8	2.9	14.7	-	(1,011.4)	485.0	1,946.0	1,751.9

1. Refer to the Annual Report and Accounts for more information, which have been made available on our website

SELECTED NOTES TO THE FINANCIAL STATEMENTS

All amounts are stated in £m unless otherwise indicated.

NOTE 1: SEGMENTAL INFORMATION

The Group provides a wide range of banking services within the UK. The Executive Committee (ExCo) has been determined to be the chief operating decision-maker of the Group. The Group's operating segments reflect its organisational and management structures in place at the reporting date. ExCo reviews information from internal reporting based on these segments in order to assess performance and allocate resources. The segments are differentiated by whether the customers are individuals or business entities. The operating costs of all business functions are allocated to the income-generating businesses. Treasury balances have not been allocated to segments to maintain clarity on underlying customer product balances.

The Group previously presented certain exceptional line items as adjustments to underlying profit at a Group level. Such items have now been classified as either operating expenses or non-operating income and aggregated within Legacy & unallocated. Prior period comparative information has been re-presented.

2022	**Core**			**Legacy &**	**Group**
	Retail	**SME**	**Total**	**unallocated**	
Net interest income	397.0	69.3	**466.3**	(8.0)	458.3
Other operating income	22.7	18.7	**41.4**	(0.3)	41.1
Operating income/(expense)	**419.7**	**88.0**	**507.7**	**(8.3)**	**499.4**
Operating expenses	(288.6)	(63.6)	**(352.2)**	(20.5)	(372.7)
Net credit impairment (losses)/gains	(5.2)	(1.6)	**(6.8)**	0.4	(6.4)
Non-operating income	-	-	**-**	12.3	12.3
Profit before tax	**125.9**	**22.8**	**148.7**	**(16.1)**	**132.6**

2021	**Core**			**Legacy &**	**Group**
Re-presented	**Retail**	**SME**	**Total**	**unallocated**	
Net interest income	284.8	47.4	332.2	(8.3)	323.9
Other operating income	20.3	16.5	36.8	0.8	37.6
Operating income/(expense)	305.1	63.9	369.0	(7.5)	361.5
Operating expenses	(259.8)	(55.1)	(314.9)	(31.2)	(346.1)
Net credit impairment gains/(losses)	0.9	(1.1)	(0.2)	(0.9)	(1.1)
Non-operating income	-	-	-	16.8	16.8
Profit before tax	46.2	7.7	53.9	(22.8)	31.1

The table below represents the reconciliation of the underlying basis and the segmental note to the consolidated income statement. The underlying basis is the basis on which information is presented to the chief operating decision maker and excludes the items below which are included in the statutory results.

		Removal of:			
2022	**IFRS statutory**	**Volatile items[1]**	**Strategic projects**	**Non recurring[2]**	**Underlying basis**
Net interest income	458.3	-	-	-	458.3
Other operating income	53.4	(8.2)	-	(4.1)	41.1
Operating income	**511.7**	**(8.2)**	**-**	**(4.1)**	**499.4**
Operating expenses	(373.7)	-	12.4	4.3	(357.0)
Net customer redress release	1.0	-	-	(1.0)	-
Net credit impairment losses	(6.4)	-	-	-	(6.4)
Profit before tax	**132.6**	**(8.2)**	**12.4**	**(0.8)**	**136.0**
Cost:income ratio[3]	**73%**				**71%**

1. In the period ended 31 December 2022, this comprises gain on shares revaluation.
2. In the period ended 31 December 2022, this comprises gains on the sale of a small legacy loan book, release of PPI provision and other exceptional costs.
3. Cost:income ratio is calculated as (operating expenses plus net customer redress release)/(operating income).

2021	IFRS statutory	Removal of: Volatile items[1]	Strategic projects	Non recurring[2]	Underlying basis
Net interest income	323.9	-	-	-	323.9
Other operating income	54.4	(2.4)	-	(14.4)	37.6
Operating income	378.3	(2.4)	-	(14.4)	361.5
Operating expenses	(348.7)	-	19.0	10.3	(319.4)
Net customer redress release	2.6	-	-	(2.6)	-
Net credit impairment losses	(1.1)	-	-	-	(1.1)
Statutory loss before tax	31.1	(2.4)	19.0	(6.7)	41.0
Cost:income ratio[3]	91%				88%

1. In the period ended 31 December 2021, this comprises gain on shares revaluation.
2. In the period ended 31 December 2021, this comprises refunds of historical ATM business rates paid, residual PPI impacts and other exceptional costs.
3. Cost:income ratio is calculated as (operating expenses plus net customer redress release)/(operating income).

The table below represents the segmental analysis of assets and liabilities.

2022	Core			Legacy &	Group
	Retail	SME	Total	central items	
Segment assets	19,841.3	388.2	20,229.5	7,903.3	28,132.8
Segment liabilities	16,607.8	3,396.8	20,004.6	6,829.2	26,833.8

2021	Core			Legacy &	Group
	Retail	SME	Total	central items	
Segment assets	19,756.0	441.7	20,197.7	9,125.6	29,323.3
Segment liabilities	17,604.4	3,461.0	21,065.4	6,506.0	27,571.4

NOTE 2: RELATED PARTY TRANSACTIONS

Parent, subsidiary and ultimate controlling party

As at 31 December 2022, the Group had two significant shareholders: SP Coop Investments Ltd and Anchorage Illiquid Opportunities Offshore Master V L.P., each holding over 20% of the B shares of the Holding Company, and therefore considered to be related parties.

During 2021, certain funds managed by Anchorage Illiquid Opportunities Offshore Master V L.P and SP Coop Investments Ltd have sold the entirety of their holdings in the Tier 2 and senior unsecured debt issued by The Co-operative Bank Finance p.l.c. and hence during 2022 they did not receive any interest payments in this respect.

A loan was recognised by Finance Company and Bank Company to achieve structural subordination of the MREL-qualifying debt (the “internal MREL”). The terms of the internal MREL are the same as those of the external MREL-qualifying debt. The total amount due from Bank Company to Finance Company at 31 December 2022 in this regard was £646.9m (2021: £402.1m) including accrued interest. The interest paid by Bank Company to Finance Company on the internal MREL instrument was £44.5m (2021: £37.0m).

Transactions with other related parties

Key management personnel are defined as the Board of Directors and Executive Committee members.

The related party transactions with key management are disclosed below:

	2022	2021
Deposits and investments at the beginning of the year	**1.6**	0.5
Net movement	**0.9**	1.1
Deposits and investments at the end of the year	**2.5**	1.6

In addition, there were £0.4m (2021: £0.1m) relating to loans to key management personnel, arising in the normal course of business.

Key management personnel

	2022	2021
Total remuneration receivable by key management personnel	**9.3**	8.6

In 2022, the total number of key management personnel was 19 (2021: 18). Further information about the remuneration of senior management personnel and material risk takers is included in the Directors' remuneration report.

NOTE 3: EVENTS AFTER THE BALANCE SHEET DATE

There are no post balance sheet events to report.

RISK MANAGEMENT

1. RISK MANAGEMENT OBJECTIVES AND POLICIES

1.1 Our approach to risk management

Responsibility for risk management resides at all levels within the Group and is supported by Board and management level committees. A three lines of defence model is deployed on the following basis:

- 1st line - are responsible for owning and managing all risks within defined appetites, complying with Risk Policies and Control Standards, ensuring supporting procedures are documented and maintained using the Group's Risk and Control Self-Assessment (RCSA), and are responsible for reporting the performance, losses, near-misses and status of risks through governance.
- 2nd line - the risk function acts as the 2nd line of defence (2LOD). The Risk Framework Owners (RFOs) are responsible for setting Risk Policies, Control Standards, Group-wide procedures and risk appetite. RFOs sit within the 2nd line with the exception of some specialist areas where the RFO sits within 1st line (for example Legal, Financial Reporting and People risk); the 2nd line risk function will provide oversight over the RFO activities in such cases.
- 3rd line - the internal audit function assesses the adequacy and effectiveness of the control environment and independently challenges the overall management of the Risk Management Framework (RMF).

Significant risks

Levels of consumer fraud continue to be a concern across the banking industry. Frauds committed against our customers were a significant contributor to our operational losses during 2022. In response, we have made significant progress in updating and implementing new systems to make it harder to defraud our customers with further implementation of upgrades planned into 2023.

Increased demands around managing consumer fraud and the migration of customers away from the Group's heritage systems to a new, improved platform caused Average Speed to Answer (ASA) metrics to fall outside of internal SLAs. Over the course of 2022 the Group deployed FTE recruitment and retention strategies, innovative use of Interactive Voice Response (IVR) and optimisation of fraud controls to correct this position. We are now confident that we have the right technology and people in place to meet ASA targets through 2023.

We have been on a significant journey of simplification, remediation and improvement in recent years, but as with many other financial institutions, the Group has instances of end-of-life IT systems that provide key services: also known as technical debt. As IT systems continue to move to their end of life, the ability to recover quickly from IT incidents reduces and exposes the Group to a widened range of cyber risks; in the context of an evolving external fraud threat, we acknowledge the potential for heightened vulnerabilities. To ensure the Group has the capability to manage change risk effectively and deliver the remediation plan for technical debt, we have invested heavily in 2022, particularly in the flagship Simplification programme. Simplification has experienced some delays in 2022, mainly due to the complexity of programme deliverables and resourcing issues. Significant time and effort has therefore been invested into re-planning the programme within extended Board oversight, in addition to ensuring the right people are in place, to allow for a safe and successful migration of customers to the new platform (see Change Risk under section 1.8 below).

The Group remains committed to continuing the progress made so far into 2023.

The Group welcomes the introduction of the FCA's Consumer Duty which comes into force in July 2023 for on sale products. This requirement for firms to act to deliver good outcomes for retail customers is entirely aligned to our ethical principles. A significant body of work is underway and will continue over the coming months, across all elements of the Group to implement a more outcomes, data-led approach with a continuous cycle of monitoring to enable the Group to identify where things are not operating as expected for customers and to act quickly to minimise the risk of harm.

Key credit risks relate to the rising cost of living, the associated affordability pressures for our customers and the risk of material credit losses to the Group. Macroeconomic uncertainty and geopolitical events (triggered to a large extent and exacerbated by the ongoing conflict in Ukraine) have impacted many economies around the world that are still recovering from the effects of the COVID-19 pandemic. In the UK, the economic effects have materialised in the form of a 4-decades-high level of inflation and multiple Bank of England base rate increases. This has resulted in both individuals and UK based businesses facing overall higher day-to-day costs equating to a challenging climate for both UK retail and SME banking customers.

To date, arrears remain low, the Group's portfolios remain robust and previously strong HPI growth is expected to mitigate against losses resulting from house price deterioration in a rising rate environment. However, we understand that the increased risk of material credit losses and operational readiness to manage the volumes of customers requiring support will continue to demand sharp focus going into 2023. To this end, close monitoring of each portfolio for signs of stress arising through the affordability stretch is undertaken through specifically developed monitoring and early warning indicators.

How the conflict in Ukraine affects our risk profile
The Group has no direct and limited indirect exposure to Russia or Ukraine which minimises the immediate financial impact of the conflict on the delivery of our strategy. However, the conflict has impacted our risk profile in the following ways:

- compliance with financial crime and anti-money laundering regulation – implementing the complex and evolving sanctions regimes introduced in response to the conflict, in all business processes including payments, supplier management and provision of support to those impacted by the conflict, and
- the conflict in Ukraine has increased the risk of cyberattacks from state sponsored groups or individual threat actors. We continue to invest in cyber defences and address known vulnerabilities in response to the heightened threat of cyberattack against UK institutions, infrastructure and our customers.

The conflict has already shown the signs of significant and long-lasting effects on geopolitics and the global economy, exacerbating the increases to energy costs and food prices which has created affordability stress for consumers and business alike. We will continue to monitor the evolution of the conflict to ensure we are able to continue to support our customers appropriately.

Key 2022 achievements and looking ahead
In 2022, we undertook an effectiveness review of the Risk Management Framework (RMF). In recognition that the Group has reduced and simplified its operations significantly over the last five years, there were a number of changes proposed to ensure the RMF is suitable for the organisation's current and future operating model. This includes rationalisation of the Principal Risk taxonomy to ensure it is representative of the Group's most significant risks and more in line with our peers. We believe implementing these changes safely will enable greater focus on the most material risks to the Group whilst also allowing for continued embedding of climate change and operational resilience as thematic risks (for more detail on how Climate Change Risk is evaluated, managed and monitored by the Group please see the TCFD report in the Annual Report and Accounts, which is available on our website).

Whilst 2022 was a challenging year it was also a hugely successful year in respect of the Group's capital position. In Q4 2022, we received the final results of the Capital Buffers component of the PRA's Supervisory Review and Evaluation Process (SREP) for 2022. The SREP outcome means the Group has now attained full compliance with total capital requirements plus capital buffers, and expects to maintain compliance with minimum requirement for own funds and eligible liabilities (MREL) plus capital buffers on a sustainable basis, following end-state requirements becoming binding from 1st January 2023.

This is the first time we have been sustainably capital compliant since 2013 and represents an important milestone in our turnaround. This demonstrates strong progress in the Group's improvements to financial stability and stress resilience within a changing economic environment. In December 2022, we received a 1 notch upgrade to our long term credit rating from Moody's to Ba1 (from Ba2) representing another step towards returning to investment grade rating. Returning to sustainable capital compliance was a key driver of this and we look forward to building on this success further.

Our active management of risk has provided a platform for the success of the business in 2022 as demonstrated by another year of resilient financial performance. Although the Group is operating in a challenging external environment that is expected to persist for some time, and we remain mindful of the significant challenges of delivering strategic change successfully (centred around the Simplification programme), the effectiveness of the Group's fully embedded RMF provides us with confidence that our risks will be managed prudently and we will remain sustainably profitable.

1.2 Overview
The Board oversees and approves the Group's RMF and is supported by the Risk Committee (RC) of the Bank. The RC's purpose is to review the Group's principal risk categories and risk appetite, report its conclusions to the Board for approval and oversee the implementation of the RMF, whilst anticipating changes in business conditions. The purpose of the RC of the Bank is to review and challenge the Group's risk appetite and RMF. The Board of the Holding Company should approve the Holding Company's risk appetite and risk policy, which shall be aligned to the RMF.

There is a formal structure for identifying, reporting, monitoring and managing risks. This comprises, at its highest level, risk appetite statements which are set and approved by the Board and are supported by granular risk appetite measures across the principal risk categories. This is underpinned by an RMF which sets out the high level policy, control standards, roles, responsibilities, governance and oversight for the management of all principal risks.

Material risks and issues, whether realised or emerging, inclusive of those documented in relation to the RMF itself are described along the lines of principal risks within section 1.8.

1.3 Our Risk Management Framework (RMF)

Further information can be found in the full Annual Report and Accounts, which has been made available on our website.

1.4 Risk management strategy and appetite

The Board has primary responsibility for identifying the key business risks faced and approving the risk management strategy through the setting of risk appetite, which defines the type and amount of risk the Group is prepared to take both qualitatively and quantitatively in pursuit of its strategic objectives. In addition, the Board approves key regulatory submissions including the Internal Liquidity Adequacy Assessment Process (ILAAP) and the Internal Capital Adequacy Assessment Process (ICAAP).

Risk appetite is translated into specific key risk appetite metrics (KRAMs) which are tracked, monitored and reported to the appropriate risk committees (refer to section 1.7). The risk appetite framework has been refreshed for 2023 and is now further aligned to our strategic objectives and imperatives and the KRAMs will highlight where the Group is outside appetite and the achievement of the strategy is at risk. In addition a further set of key risk indicators (KRIs) are in place and reported monthly, for each of the risk types defined within the RMF.

1.5 Our risk culture

A critical supporting factor of the RMF is the risk culture in the Group; this is a shared set of values and behaviours that defines how all colleagues approach the management of risk. This culture begins at the top of the organisation with the Group's Executive team who lead by example with consistent and clear communication of their commitment to managing risk at all levels of the business. Risk management is included in every colleague's objectives each year and is embedded within the Group scorecard against which performance is measured.

The Group has committed to embedding a strong culture of risk management and provides regular training and opportunities for colleagues to refresh knowledge on the RMF and opportunities for leaders to share knowledge and experience in respect of risk management in their roles. Culture is measured through continued monitoring of the Risk section of the CEO scorecard, the RMF dashboard which includes metrics on Risk process adherence through RMF-focussed 2nd line of defence assurance reviews and through 2nd line of defence oversight and feedback.

A Group-wide risk culture survey was conducted at the end of 2021 in order to assess the underlying behaviours and attitudes towards risk at all levels in the organisation. The results of the survey were extremely positive and pointed to a culture sustained by an open and honest risk environment, where colleagues are encouraged and not afraid to do the right thing and understand their responsibilities with regard to risk. Improvements identified in specific areas were actioned during 2022 and will continue during 2023.

We remain fully committed to delivering a challenging change agenda successfully in 2023. We recognise that the volume of large change programmes – with particular focus on the Simplification programme – carry significant execution risks. We have therefore invested significant time and effort into re-planning the programme in addition to ensuring the right people are in place to allow for a safe and successful migration of customers to the new platform.

1.6 Evolution of the RMF in 2022

We continually seek to enhance and further embed the RMF to ensure efficient and effective risk ownership and management within risk appetite, supporting appropriate customer outcomes and the delivery of its strategic plan (the Plan). The focus during 2022 has been to continue to embed the RMF through changing structures, responsibilities and Group strategies, to adapt where required ensuring stability and effectiveness, but also to simplify where possible without detriment to the management of risk or the risk culture. The secondary driver was to consider where simplification could be achieved in order to focus resource on significant and material risk-related activities.

During the year, a number of initiatives have introduced further efficiencies to the RMF without any reduction in the effectiveness of managing risk. This has been possible due to the maturity of the RMF and the level of embedding that has been achieved:

- continued training for those new to roles (e.g. Risk Framework Owners and Risk Managers) with improved mandatory training and targeted topic-based training, (e.g. Root Cause Analysis);
- continued improvements to key operational risk processes, for example, focus on Root Cause Analysis for the more material Risk Events and the reduction in frequency of appropriate updates;
- the improvements to the risk appetite framework;
- the removal of the gap analysis process for refreshed Control Standards due to the level of embedding of the RCSA process;
- the initiation of a review of key controls to improve the quality and efficiency of key control testing and focus on the most significant controls that mitigate our key risks; and
- the risks relating to operational resilience have been incorporated into the RMF and managed thematically.

In recognition that the Group has reduced and simplified its operations significantly over the last five years, there were a number of changes proposed (effective from 1 January 2023) to ensure the RMF is suitable for the organisation's current and future operating model. This includes rationalising the Principal Risk taxonomy to ensure it is representative of the Banks most significant risks and changes to how risk metrics are constructed and reported. We will continue to simplify and evolve the RMF in 2023 with a specific focus on continuing with the key control initiative whilst driving commitment and understanding of risk management at all levels of the organisation.

1.7 Our risk governance

The Board is the key governance body and is responsible for strategy, performance and ensuring appropriate and effective risk management. It has delegated the responsibility for the day-to-day running of the business to the CEO. The CEO has established the Executive Committee to assist in the management of the business and deliver against the approved Plan in an effective and controlled manner.

The Board has established Board committees and senior management committees to oversee the RMF, including identifying the key risks faced and assessing the effectiveness of any risk management actions.

Each committee in the Group's governance structure is required to manage and assess risk as part of its terms of reference; however, a number of these committees are specifically focussed on risk. Further comment is provided below detailing the specific areas of risk on which each committee focusses.

Committee	Risk focus
Board Chair: Bob Dench	The Board has collective responsibility for the long-term success of the Group and the Bank. Its role is to provide leadership of the Group within a framework of prudent and effective controls which enable risk to be assessed and managed. It sets the values and standards and ensures the obligations to its shareholders, customers and other stakeholders are understood and met. The Board sets the strategy and approves plans presented by management for the achievement of the strategic objectives it has set. It determines the nature and extent of the significant risks it is willing to take in achieving its strategic objectives and is responsible for ensuring maintenance of sound risk management and internal control systems.
Risk Committee (RC) Chair: Derek Weir	RC is responsible for reviewing and reporting its conclusions to the Board on the Bank's risk appetite and propose for approval by the Board and oversee the implementation of a Risk Management Framework, taking a forward-looking perspective and anticipating changes in business conditions.
Executive Risk Oversight Committee (EROC) Chair: CRO	EROC is responsible for oversight of the risk profile of the Group (within the agreed Board risk appetite). EROC reviews and challenges the risks associated with the Group's business strategy, plans and overall management of risks. EROC achieves some of its objectives through delegating responsibility to sub-committees: OCROC, MROC, PROC and CROC. EROC will escalate, where appropriate, to the Board via the RC.
Executive Committee (ExCo) Chair: CEO	ExCo is responsible for defining and implementing the Board-approved strategy successfully by monitoring and managing delivery against plan and applying appropriate risk management actions to emerging risks.
Asset and Liability Committee (ALCo) Chair: CFO	ALCo is primarily responsible for overseeing the management of capital, market, earnings, liquidity and funding risks. Its responsibilities include identifying, managing and controlling the balance sheet risks in executing its chosen business strategy, ensuring the capital and liquidity position is managed in line with appropriate policies and that adequate capital is maintained at all times. In order to closer align the function of key committees, ALCo is to become a subcommittee of the Board Risk Committee. This change will further reinforce the mitigation of financial risks through embedding a structure whereby key asset and liability management decisions are set within a risk governance setting.
Model Risk Oversight Committee (MROC) Chair: Director of Capital, Impairment and Model Development	MROC ensures, on an ongoing basis, that the model rating systems and material models are operating effectively. This includes providing Executive level review and challenge of the model risk and the impact of model risks on the Group's business model and strategies. MROC also provides oversight of the Group's IRB permissions, including the exemptions where the Group applies the Standardised Approach to calculate Pillar 1 capital requirements.
Credit Risk Oversight Committee (CROC) Chair: Director of Credit Risk	CROC is responsible for monitoring significant credit risks and issues within the entire credit lifecycle, the controls and management actions being taken to mitigate them and to hold to account the Executives responsible for actions. CROC reviews the credit risk strategy on an ongoing basis, making recommendations to EROC as appropriate.
Operational, Compliance & Financial Crime Risk Oversight Committee (OCROC) Chair: Director of Compliance, Director of Operational Risk	OCROC is responsible for monitoring significant operational risks and issues including significant conduct, regulatory, product, reputational, fraud and AML risks and issues, the controls and management actions being taken to mitigate them and to hold to account the Executives responsible for actions. OCROC oversees the current and emerging operational risk profile, ensuring key risk exposures are managed within risk appetite and reported to EROC as appropriate, including the monitoring of adherence to the RMF alongside a process for continuous improvement.
Pension Risk Oversight Committee (PROC) Chair: Director of Capital, Impairment and Model Development	PROC is responsible for oversight of all aspects of pension arrangements which the Group either sponsors or participates in, to ensure cost, risk, capital, investment and employee requirements are met.

1.8 Principal risk categories
The following pages outline the key financial and non-financial risks as identified by the RMF and approved by the Board as risks that could result in an adverse effect on the business, operating results, financial condition, reputation and prospects.

OPERATIONAL RISK

Definition:
Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems or external events.

Operational risk has 13 sub-risks as part of the Group's RMF. These sub-risks are included in the commentary below. All sub-risks are subject to annual review and each risk is managed individually and in line with the Group's RMF, including having individual risk framework owners, risk policies and control frameworks

Key themes:
Operational risk levels remain elevated due to high levels of fraud seen industry wide, and a reliance on both manual processes and legacy IT systems. The impact on our customers from inflation and interest rate increases has been closely monitored during 2022 and will remain a key focus throughout 2023. The most significant operational risk themes are outlined below.

Change risk – There were a number of programmes launched to safely ensure compliance with regulatory developments and to implement improvements to the Group's systems over the course of 2022 with a high volume of activities planned across 2023 and beyond. Whilst these developments represent opportunities to provide an improved service to our customers, remove system vulnerabilities and limitations and reduce technical debt, we recognise that large projects will inevitably carry significant risks. In light of recent fines in the industry levied by the PRA and FCA after root cause analysis it is clear how critical effective planning, robust governance and having the necessary level of operational resilience in place is to delivering major change. We have invested significant time and effort into planning activity to mitigate the risks of non-compliance, late or failed delivery and to ensure that the intended objectives of these various programmes are achieved.

Delivering these significant developments is core to the Group's strategy, particularly the migration of heritage Britannia and WMS Platform IT infrastructures to a single mainframe for mortgages and savings (Simplification). In recognition of the strategic importance of the programme, a temporary Board sub-committee was set up in December 2021 to oversee and support the management team to deliver the programme successfully. The Group has experienced delays in 2022, particularly across the mortgage re-platforming aspect of the programme, in part due to complexity of programme deliverables but also due to resourcing issues. We have therefore invested significant time and effort into completing re-planning activity during 2022, ensuring the right people are now in place. Executive and Board sub-committee focus has and will continue to be applied to the project, with clear accountability on ownership and delivery. Our regulators are receiving frequent updates and multiple controls have been put in place to drive visibility, transparency and accountability of this project to ensure a safe and successful migration of customers to the new platform. Completion of this programme will mean a significant reduction to the Group's operational risk profile and technical debt exposure during 2023. Robust programme monitoring and oversight of key developments has been, and will continue to be, in place across all three lines of defence.

Fraud – Fraud losses continued to be a significant contributing factor to operational losses in 2022 with impersonation fraud representing the most significant proportion of the fraud typologies perpetrated against our customers. Card fraud losses have greatly reduced since implementation of a PSD2 card not present solution in September though overall losses for the year will still be outside tolerance.

We provide targeted education to our customers through all available channels and introduced a number of preventative measures during the year including improved scam warnings and customer messages. The Group is a signatory to the industry 159 fraud reporting initiative which assists customers who believe that they may have been or are being targeted by fraudsters and also provides a direct route to our fraud team.

A behavioural biometrics tool (Trusteer) has been rolled out to reduce the impact of losses arising from account take over frauds. Trusteer Release 2 is now alerting with additional step up on higher risk on-line activity. Although tactical controls have been implemented in SME the delivery of Detica (SME payment screening) in H1 2023 will provide further protection against authorised push payment loss.

Technical debt – As with many other financial institutions, the Group has instances of end-of-life IT systems that provide key services. To reduce the associated risks and minimise the impact of any disruptions, the Group has a strategy to remove the highest risk legacy systems and has added additional resilience arrangements to protect IT services until replacement. Funding for this strategy has been approved for 2023 and is subject to regular monitoring and reporting against progress.

Cybercrime – As with other technology dependent financial institutions, the Group and its customers are exposed to both actual and attempted cyberattacks from parties, with malicious and/or criminal intent. These risks increase as the Group increases its reliance on digital products, services, key functions and distribution channels.

There is greater exposure to cyberattacks where systems are reliant on legacy technologies, as highlighted in the technology debt section above. The Group is subject to the risk that a cyberattack may result in temporary loss of availability of systems for its colleagues and/or customers and potential disclosure of confidential information. This can cause business disruption and legal exposures that may have adverse effects on the Group's financial condition, operating results, reputation and brand.

To minimise cyber threats, the Group has a Board-approved cyber strategy that is regularly refreshed. The strategy drives the annual cyber investment for security tools, processes and capability to counter the ever-evolving cyber threat landscape in addition to remediating its legacy IT estate. The most recent external benchmarking activity has evidenced an improvement year-on-year in the maturity of the Group's cyber framework, while acknowledging the risks associated with legacy systems. Where specific risks arise, bespoke solutions are evaluated and deployed to minimise exposures to cyber threats until older IT systems are replaced. In addition, annual testing aligned to the Bank of England's CBEST cyber assessment framework is completed with industry-accredited third parties to understand technical control effectiveness and enhancements.

Third party supplier management – The Group continues to be dependent on suppliers to support or provide key banking services. Since the COVID-19 pandemic, we have taken steps to improve the control environment with no significant disruptions experienced from suppliers. The Group is now materially compliant with revised guidelines on outsourcing arrangements that came into force in the first quarter of 2022. While further improvements are required to mature controls and risk management over all suppliers, the Policies and Controls standards as part of the RMF have been updated to reflect the new requirements, with identified gaps subject to monitoring and reporting. In addition, an external 3rd party has been engaged to support management in their assessment of supplier risk management, aligned to industry best practise and to deliver further improvements.

We continue to work closely with Capita to ensure a seamless re-integration of mortgage servicing operations back in-house, ensuring that resourcing levels are appropriate to support our customers during a tough economic period. An agreement was reached with Capita to extend the mortgage services under the existing contract for three months to 28 February 2023. This extension was to provide comfort that the Group has appropriate IT, operational and systems access requirements in place to allow for a safe and sustainable migration.

Anti-money laundering (AML) – Significant progress has been made in improving the suspicious activity report (SAR) SLA and AML resource levels, with appropriate management focus and action being taken throughout 2022, improving the end of year position.

The migration of customer data feeds from the Group's heritage Britannia screening system into the implemented NetReveal screening system was complete in December 2022, this migration will provide improvements to AML controls and address some of the previous limitations of legacy AML systems. The Group is managing the risk through application of manual and system based workarounds. System upgrades will remain a key Group focus into 2023.

The Group's dedicated regulatory risk team within 2LOD maintain industry developments via a fully embedded horizon scanning process. Emerging risk, including regulatory changes, external regulatory breaches and industry developments remain a key focus of the Group's 2LOD AML advice and oversight team. The team are attendees on industry-led working groups, to ensure a consistent approach to regulatory change is fully understood and aligned to our industry peers.

We have seen examples in the industry in the final quarter of 2022 where the FCA has demonstrated that they will take appropriate action where institutions do not undertake necessary measures to identify, assess, monitor, and manage money laundering risks. The Group's 2LOD AML advice and oversight team are reviewing the Group's AML systems and controls to ensure our financial crime defences remain robust, adequate and effective to mitigate the risk that the Group is used to facilitate the laundering of the proceeds of crime, the financing of terrorist or proliferation activity or to breach financial sanctions legislation.

Conduct risk and compliance – We welcome the FCA Consumer Duty and the increase in the level of consumer protection it will introduce. As an ethical bank, we already strive to ensure that we act in good faith, avoid causing foreseeable harm and support customers in pursuing their financial objectives. Consumer Duty is a further opportunity to strengthen and sharpen our conduct frameworks to evidence that the Group is delivering good outcomes.

The needs of our customers continue to evolve as they adapt to living with COVID-19 but face new economic pressures due to the cost of living. We have continued to react and support our customers' need for forbearance in light of the increased cost of living, in full consideration of the FCA's latest guidance for borrowers. We have also responded to the ever-changing tactics of fraudsters with technology and process changes to disrupt transactions, whilst ensuring our customers are treated fairly and receive good outcomes.

The Group continues to invest in digital channels in line with customer preferences, but recognises the diverse needs of our customers. In addition, we have maintained commitment to our other channels through the relocation of our Nottingham branch to a more accessible location, and investments in increased contact centre resource. We continue to operate dedicated phone lines to meet the needs of our most vulnerable customers, including in year adoption of the 159 fraud contact initiative.

The changing needs and requirement to support our vulnerable customers increases annually, with the FCA estimating c.50% of the UK population exhibit vulnerable characteristics. In response the Group has invested in digital changes enhancing accessibility and ease of use. It has also reintroduced the non-repayable emergency hardship fund for those customers who are in severe need of support, extended our partnership with Citizens Advice by introducing digital self-service links and signed up to the industry Financial Abuse Code.

In October 2018, Mortgage Agency Services Number Five Limited (MAS 5), a subsidiary of the Group, received a complaint from a mortgage customer regarding changes made to MAS 5's standard variable rate between 2009 and 2012. An application for a judicial review of FOS's jurisdiction decision, on the grounds that the Group considered this part of the complaint to be time-barred, was dismissed in July 2022. The Group remains satisfied that these historical variations were applied fairly and in accordance with the terms and conditions of the mortgage contract. Until such a time as the FOS communicates to the Group its final decision on the merits of the complaint, it is not possible to predict the scope and ultimate outcome on the Group. No provision is held in respect of this matter – further information can be found in the full Annual Report and Accounts, which has been made available on our website.

The Group appreciates the issues faced by mortgage borrowers who find themselves trapped, providing targeted communication to customers and offering a process that assesses re-mortgage eligibility. The Group continues to engage with industry bodies, the FCA and political groups to discuss and find solutions to these issues.

Payments risk – In 2022 there were no material breaches of payment scheme rules, as the Group implemented key infrastructure and consumer focussed changes, such as Confirmation of Payee updates. Payment risk remains a key area of focus and the Group will continue to invest to improve the Bank's payment systems and architecture, which continues to evolve to serve the real-time on-demand requirements of its customers. Preparations for the Bank of England's (BoE) Real Time Gross Settlement (RTGS) service, which not only operates CHAPS but is the infrastructure that holds accounts for banks, building societies and other institutions, are well underway for initial transition states in 2023.

Operational resilience – Operational resilience was added to the Risk Management Framework (RMF) as a Thematic Risk in 2022 and is defined as the risk of the Group suffering operational disruptions arising from the inability to prevent, adapt, respond to, recover and learn from previous events. operational resilience events are expected to occur however the Group's appetite is to have plans in place that mitigate and/or minimise disruptions, ensuring reduced harm to customers, maintaining the safety and soundness of the Group and limiting impacts to the wider financial sector. The Group has no appetite for any breach of regulation in relation to operational resilience and will, at all times, seek to achieve and maintain compliance with all relevant legal and regulatory requirements.

The Group has, in line with regulatory expectations, completed a programme of work to identify the Important Business Services (IBS), set impact tolerances for the maximum tolerable disruption, map and document the components of each IBS and complete scenario testing. Where vulnerabilities have been identified, remediation plans are in place and are being tracked and monitored along with operational resilience Key Risk Indicators (KRIs). We will continue to monitor the effectiveness of operational resilience risk management through RMF activity, dedicated operational resilience reporting in governance, dedicated assurance reviews completed as part of the three lines of defence risk management model and a multi-year scenario testing plan.

Top and emerging risks:
Cost of living – The rising cost of living for our customers continues to require critical focus to ensure that the operational and loss consequences to the Group are well understood. Analysis looking at the current affordability position of our mortgage customers indicates a robust portfolio with a strong LTV position; however, we recognise that increased affordability issues will require a greater level of operational readiness to manage the volume of customers potentially requiring support. In an effort to support customers we have commenced test and learn activity for contacting potentially 'at risk' mortgage customers which will develop over time.

Economic and Geopolitical risk – 2022 was a turbulent year with the impacts of the ongoing conflict in Ukraine felt globally. The impact of this instability was realized in the UK in the form of increased interest rates, and challenges around affordability of key essentials which was exacerbated by domestic political uncertainty. Whilst the latter half of Q4 has seen a more stable domestic position, we will continue to monitor impacts on our customers resulting from further political disruption. There is also heightened geopolitical and global economic risk in the event of a conflict in Taiwan which could create further instability in the UK.

Regulatory changes:
The Group is committed to delivering a high volume of significant regulatory changes in 2023 and beyond to enhance customer protection and outcomes, and strong financial resilience. Key changes from the PRA, FCA, HMT and the BoE include:

- FCA Open Banking – FCA's aim to remove the barriers identified to the continued growth of Open Banking and support competition and innovation in the sector. The FCA proposes several changes to the Strong Customer Authentication Regulatory Technical Standard (SCA-RTS);
- FCA Consumer Duty – The new Consumer Duty is designed to increase the current level of consumer protection across the retail financial services market, including the introduction of a new 12th Principle, supported by enhanced cross-cutting rules and outcomes;
- PRA Consultation Paper (CP) on implementation of the Basel 3.1 standards – The proposals in the CP propose further reforms in the measurement of risk weighted assets (RWAs). It sets out proposed changes to improve the measurement of risk in internal models and standardised approaches, to reduce excessive variability in the calculation of risk weights, thereby making firms' capital ratios more consistent and comparable. In addition, the proposals aim to facilitate effective competition by narrowing the gap between risk weights calculated under internal models, which are typically used by the larger firms, and standardised approaches. The CP also contains

revised proposed criteria for determining which firms would be in scope of the 'strong and simple' prudential framework that the PRA is developing. The proposed implementation date for the changes is 1 January 2025, with transitional arrangements that give firms significant time to adjust to the new framework;

- FCA Credit Information Market Study – The FCA launched the study because it had concerns about the quality of credit information, strength of competition in the market, and the extent of consumer engagement and understanding. The regulator's goal is to improve the quality of credit information, so that lending decisions better reflect people's underlying financial circumstances. The Group anticipates further engagement and changes in processes and reporting with the relevant credit rating agencies; and
- Regulatory Reform – In December, the Chancellor of the Exchequer announced the 'Edinburgh Reforms', set to drive growth and competitiveness in the financial services sector. These represent one of the most substantial packages of financial services regulatory change in recent years, and together with the Financial Services and Markets Bill, will set the UK regulatory agenda for many years to come.

The Group recognises that the high volume of regulatory change carries significant execution risks and represents a significant resource demand across the business. In 2022, we experienced some issues in relation to delivering regulatory change on time, missing the deadline for Card Not Present (CNP) transactions and informing our regulators that we will miss the FCA Open Banking deadline set for 2023. We remain fully committed to delivering a challenging regulatory change agenda successfully in 2023 and have therefore invested significant time and effort into planning and building the capability to mitigate the risks of non-compliance or late or failed delivery.

Mitigating actions:
Ongoing management, oversight and reporting of key risks and controls by the Group's three lines of defence and the adoption of a thematic approach to managing operational resilience and climate change.

Management, oversight and reporting of risk through the Group's risk governance structure. The management of risk and controls continues to be reflected within all colleagues' performance objectives and key measures of performance against the RMF are included in the Group's scorecard.

Key indicators:
In the current year, 87.2% of net losses arose from external fraud (2021: 85.3%).

CAPITAL RISK

Definition:
The risk that the Group's regulatory capital resources are inadequate to cover its regulatory capital requirements.

Key themes:
Capital compliance – From 1 January 2023, the Group's MREL is set at 2xTCR (end-state requirement), from its transitional requirement of TCR+£400m as at the end of 2022.

In April 2022, the Group successfully completed a £250m MREL-qualifying senior debt issuance (following the £200m issuance completed in Q4 2020 and £200m Tier 2 subordinated notes issuance in 2019), with the majority of these notes placed with third-party investors. The Group has accrued CET1 resources of £952.4m in 2022, providing it with total MREL-qualifying resources of £1,599.3m. Whilst debt issuances created downward pressure on net interest income, they represent the continued strengthening of the Group's MREL position and resilience to deteriorations in external and/or internal factors.

In October 2022, we notified the market that we expect to sustainably achieve MREL plus total capital buffers compliance for the foreseeable future, following the PRA's review of the Group's Pillar 2 capital requirements in 2022. This was a full year ahead of schedule, where previously we had committed to returning to sustainable capital buffers compliance by the end of 2023. This includes absorbing the impact of the increase in the UK-specific countercyclical buffer (CCyB) rate from 0% to 1% in December 2022 and the FPC's planned increase from 1% to 2% in June 2023. The activity undertaken to de-risk the Group over recent years, our approach to risk management and return to profitability all mean that the Group is well-positioned to remain compliant with all capital requirements.

Our structured debt continues to trade well in secondary markets and in December 2022 we received a 1 notch upgrade to our long term credit rating from Moody's to Ba1 (from Ba2), positioning the Group well to execute further capital markets transactions in the future if necessary. Our shareholders remain supportive of our business and we remain strongly committed to maintaining full capital compliance.

Risk weighted assets – Our risk weighted assets (RWAs) at 31 December 2022 total £4,816.2m. RWAs reflect our risk adjusted assets factoring in probability of default, loss given default and exposure at default. This calculation is used to derive the capital requirement of the Group. Increases in RWAs are driven either by increases in the underlying assets or increases in the risk weighting (or density) assigned to these assets. Significant changes in RWAs are typically driven by changes in modelling requirements, for banks that have permission to use the Internal Ratings Based (IRB) approach. The Group, alongside other IRB institutions, has faced challenges with respect to the development of its Secured IRB models to ensure compliance with PS11/20.

From 1 January 2022, the Group raised a model adjustment to reflect the expected impact of PS11/20 on its Secured RWAs, whilst model development remained ongoing. This PMA was revised in December 2022 to reflect progress in the development of compliant models. The Bank expects to submit its LGD and PD models to the PRA for approval in H1 2023. The implementation of these models is expected to drive an increase in RWAs versus live models, although this increase is reflected in the model adjustment in place as at 31 December 2022.

The macroeconomic environment – Adverse changes in the macroeconomic environment drive capital risk through increases in capital requirements and/or reductions in capital resources. Throughout 2022, we have observed a deterioration in macroeconomic variables, with record-high inflation peaking at 11.1% in September, dampened house price growth within the second half of the year and contractions in GDP as the UK faces into a period of negative growth. Fiscal volatility, coupled with the ongoing invasion of Ukraine by Russian forces, has compounded these conditions and we continue to closely monitor the impacts that all factors may have on our capital position.

However, continued profitability coupled with the Group's low-risk balance sheet provide resilient foundations on which to enter a period of macroeconomic downturn. The issuance of £250m MREL-qualifying senior notes in April 2022 alongside the Group's return to sustained MREL plus total capital buffers compliance also minimise the risks to capital adequacy arising from market uncertainties.

Mitigating actions:
Whilst we now expect to sustain profitability in future periods, we are reliant on the successful implementation of our strategy, which is subject to significant oversight and monitoring, including by the Board. Recognising that our income profile is concentrated around interest income, we are committed to diversifying our income streams through 2023 and the life of the financial plan.

The Group has embedded capital risk monitoring across the organisation and closely manages its current and future capital position from a TCR, MREL and leverage ratio perspective. Capital management activities at all levels of the Group are overseen by the 2nd and 3rd lines of defence. The Group engages with its regulators to regularly update them on its capital position and we remain committed to maintaining this engagement following our return to sustainable capital buffers compliance.

Emerging risks:
Financial regulatory changes – On 30 November 2022, the PRA released CP16/22 – Implementation of the Basel 3.1 standards. The PRA has proposed a series of changes to the current approach to calculating capital requirements to be phased in from 1 January 2025. This represents the most significant changes to the prudential regulatory capital framework since the implementation of Basel III in 2014. The Group has reviewed the proposals outlined in CP16/22 and is currently in the process of completing a full assessment of the impacts to its capital position, with the successful implementation of Basel 3.1 being key risk focus for the Group across 2023 and 2024.

The PRA has also outlined that it intends to consider its approach to setting Pillar 2 capital requirements in light of the implementation of Basel 3.1. The PRA will provide further details as it progresses with its Pillar 2A review (expected in 2024). With respect to Pillar 2B, consideration will be given as to the impact of changes in the size of firms' Combined Buffer due to changes in Pillar 1 RWAs, when setting the PRA Buffer.

The Group has begun a detailed process to assess these impacts and is engaging with wider industry bodies to consider its responses during the consultation period, which ends on 31 March 2023. The Group is prepared to implement the proposed changes and remains cognisant of the magnitude of the development required. The Group will update the market of potential impacts following the release of the PRA's final policy statement on the implementation of Basel 3.1 standards.

Market uncertainty – As noted, material uncertainties remain with respect to the global macroeconomic environment and the Russian invasion of Ukraine. We continue to monitor these risks and will take actions to mitigate risks to our capital position if conditions deteriorate further.

Target capital ratios:
The Board's view of the ongoing level of CET1 capital required by the Group in the medium term to maintain and grow the business, deploy in suitable investment opportunities, meet current and future regulatory requirements and cover uncertainties is around 15%, subject to the preceding completion of steps to optimise the Group's capital resources composition in the context of its regulatory requirements, including issuance of replacement capital instruments.

This takes into account, amongst other things:

- The minimum Pillar 1 CET1 capital requirement of 4.5 per cent of risk weighted assets;
- The Group's individual capital requirement set by the PRA of 5.05%, of which a minimum of 2.84% must be met through CET1 capital;
- The Group's Capital Requirements Directive IV buffers of 3.5%, in aggregate;
- The Group's PRA Buffer; and
- The desire to maintain a stable and sustainable ordinary dividend policy in the context of underlying profitability from year-to-year.

Should Additional Tier 1 capital instruments not be issued as part of the optimisation of capital resources, this medium-term target CET1% ratio would rise to c.17%.

Key indicators:
CET1 ratio – 2022: 19.8% (2021: 20.7%)
Total capital resources – 2022: £1,146.5m (2021: £1,109.0m)
Leverage ratio (PRA) – 2022: 4.0% (2021: 3.8%)

CREDIT RISK

Definition:
Credit risk is the risk to profits and capital that arises from a customer's failure to meet their legal and contractual payment obligations. Credit risk applies to retail, SME and treasury.

Key themes:
Managing the profile of lending to new and existing customers is key to the ongoing management of the Group's exposure to credit risk. This involves the continual optimisation of its strategies across all portfolios, using both internal and external customer performance data, as well as ensuring the appropriate oversight of their performance.

Retail secured and unsecured portfolios – The Group's strategy continues to focus on growth in new mortgage business volumes principally through mortgage intermediaries. Nevertheless, the Group recognises that it remains heavily reliant on interest income from its mortgage portfolio and is therefore still committed to seeking opportunities to diversify its income streams and yield whilst remaining cognisant of the credit implications of this approach. The monitoring of the unsecured portfolio is a key risk focus of the Group, especially given prevailing macroeconomic conditions. In response to this, the Group has instigated an unsecured cost of living task force to review key components of customer management, arrears strategies and processes to ensure they remain fit for purpose throughout 2023. In addition to this, a suite of new unsecured stress early warning indicators have been developed in order to more closely monitor potential changes to the Group's asset quality.

Key risks in 2022 and moving into 2023 relate to the macroeconomic impacts from rising inflation and heightened interest rates; especially for those customers coming off their existing fixed rates. Unemployment is also likely to increase in 2023, and all these factors could lead to more customers facing financial difficulty or falling into arrears. The annual affordability calculator refresh has incorporated rising costs into the affordability calculation for new secured and unsecured credit applications.

Mitigating actions:
Credit risk is managed within an agreed set of risk appetite measures for each portfolio, which are monitored through a clearly defined Risk Management Framework. All credit exposure mandates are approved within a clearly defined credit approval authority framework.

Whilst the Group's portfolio is low risk and underpinned by robust credit strategies, the cost of living crisis is impacting everyone across the UK, and we have undertaken an updated affordability assessment of our Platform residential secured portfolio to understand what impact the rising cost of living as well as rate increases for customers with rate maturities in 2024 and 2025 will have to their household disposable income. This has enabled us to identify those customers most at risk of falling into a negative disposable income position and therefore needing support. Positively, the average level of disposable income for the current portfolio is £1,261 per month and 93% of these customers have a disposable income estimated to be more than £250, based on their current mortgage rate. Applying a rate shock to customers with products maturing in the next 2 years, average disposable income reduces to £1,060 per month (maturing in 2023) and £1,036 (maturing in 2024). Customers considered "at risk" based on their refreshed net disposable income (less than minus £100) have been profiled compared to those not at risk. Additionally, in cases where such customers had both a disposable income of <£250, and an LTV of >50%, a stage 2 SICR transfer was applied. Importantly, from a loss perspective, there were no customers maturing before 2025 with both an LTV higher than 90% and identified as being "at risk".

The Group also tracks a series of early warning indicators specifically relating to the cost of living crisis, and whilst there are currently no concerning trends, there are some areas that require close monitoring due to normalising spending habits as the UK comes out of the COVID-19 pandemic.

To support customers facing financial difficulty earlier, the Group operates a pre-arrears contact strategy to unsecured customers, with roll out recently begun for secured. 95% LTV lending has been managed through higher score cut-offs and restricting flats/maisonettes as acceptable collateral. A significant proportion of 95% LTV applications are also reviewed by the Group's underwriting team. The Group's secured portfolio is slightly less exposed to both river/sea and surface flood risk when compared to the UK property portfolio as a whole. In addition, the risk to the Group's secured portfolio from subsidence is also slightly lower than the UK as a whole.

Emerging risks:
The housing market has continued to remain buoyant in 2022, however there are signs house price growth is slowing as we go into 2023 and this will be closely monitored.

There is a risk that the cost of living crisis and an increasing interest rate environment will result in customers being unable to sustain their credit obligations. To date, the Group's secured and unsecured assets remain high quality, with arrears volumes remaining low and stable.

Although our criteria on lending against high rise properties has meant limited exposure to cladding issues across our mortgage portfolios, we continue to monitor ongoing developments and to take actions to mitigate our risks as required.

SME portfolio – The SME portfolio offers significant future growth potential within chosen sectors, and the focus during 2022 has been on developing the Risk Management Framework to support a selective growth strategy, combined with continuing to closely monitor the existing portfolio as customers re-establish their businesses within a post-COVID-19 environment.
Customers within the SME portfolio that are experiencing financial difficulties are being supported with tailored forbearance solutions where appropriate, as they attempt to manage their businesses during a period of economic instability and uncertainty. Proactive engagement with customers, including those with Bounce Back Loan (BBLs) scheme and Coronavirus Business Interruption Loan Scheme (CBILS) facilities has so far minimised any material increase in those necessitating recovery action. This will remain an area of close scrutiny, as a prolonged economic downturn may mean increased uncertainty around the longer term viability of SME businesses.

SME customers are having to manage the impact of rising inflation, higher interest rates and the need to increase wages against a backdrop of high employment and a shortage of skills in some sectors. We have further developed the use of internal and external Early Warning Indicator reports to support close monitoring and ensure that strategies are in place to identify and contact 'at risk' customers. Where vulnerability is identified, adjustments are made, as necessary, to support the best outcome for the customer.

Mitigating actions:
Credit risk is managed within an agreed set of risk appetite measures for each portfolio, which are monitored through a clearly defined Risk Management Framework. All credit exposure mandates are approved within a clearly defined credit approval authority framework.

During 2022, there has been an increased focus on affordability assessments throughout the loan lifecycle and a robust sensitivity analysis undertaken at origination to account for rising costs and interest rates. Training has been undertaken in 1st and 2nd line teams relating to the identification of early warning indicators that may suggest financial difficulty and also around the importance of prompt signposting of customers to external sources of advice.

Emerging risks:
Where SME businesses are not able to pass on the impact of rising costs to their own customers, it is expected that there will be an increase in businesses failing. This may be exacerbated by those government loan scheme customers that have exhausted the Pay as You Grow solutions that have been available to them. All attempts at early intervention will continue so that flexibility may be made available for viable businesses. In this regard, resourcing levels of business support teams will remain under review to ensure we are able to meet this increasing challenge in the year ahead.

Treasury – The Group's treasury portfolio is held primarily for liquidity management purposes and, in the case of derivatives, for the purpose of managing market risk. The Group monitors the risk to earnings and capital arising as a result of any of its treasury counterparties defaulting on their legal and/or contractual obligations through its Treasury Credit Risk Policy and Control Standards.

There have been minimal movements (including credit rating downgrades) in the low-risk profile of the treasury portfolio during the year and the Group has not experienced any historical defaults. The exposures remain predominantly concentrated to counterparties rated AA- or higher, suggesting a very low probability of default. The Group's credit monitoring has not identified any material changes in the creditworthiness of its treasury counterparties despite recent geopolitical tension, macroeconomic and market instability manifesting through the early signs of global recession, although this will continue to be monitored closely as the impacts may materialise in the medium to long term.

Mitigating actions:
Credit risk is managed within an agreed set of risk appetite measures for each portfolio, which are monitored through a clearly defined Risk Management Framework. All credit exposure mandates are approved within a clearly defined credit approval authority framework. Regular monitoring of rating actions, market events and financial results must be undertaken and counterparties may be placed on the Watchlist: a list of counterparties that require additional management focus over and above that provided in the normal course of business. This could be due to an actual default, an increased likelihood of default or an event that has the potential to result in a marked change in risk profile.

Emerging risks:
Current macroeconomic and market instabilities represent a challenging external environment for all banks, globally. Potential headwinds to future performance may translate to increased credit risk in the future. This is particularly relevant to UK banks where significant market reaction following the government's controversial mini-budget in October (albeit somewhat calmed since the immediate fall-out), has fuelled record levels of inflation, applying further pressure to household finances and the cost-bases of many businesses which could impact the asset quality of a number of banks in the UK and cause deterioration in institution credit quality. Expanding interest margins and strong balance sheets observed by market commenters are generally expected to counter the impact of economic slowdown and cushion an expected rise in problem loans.

Key indicators:
Impairment charge: £6.4m (2021: £1.1m)
Core mortgage accounts 3 months in arrears (by balance): 0.09% (2021: 0.09%)

LIQUIDITY AND FUNDING RISK

Definition:
Liquidity and funding risk is the risk that the Group is unable to meet its obligations as they fall due or can only do so at excessive cost.

Key themes:
The Group maintained a strong level of liquidity through 2022 against regulatory minimum, but also recognising the potential for changes in customer profiles and market conditions given the uncertain economic backdrop. The BoE liquidity support to the industry through TFSME has provided the Group with an additional funding source to support its lending activities, funding profile and liquidity resources.

The Group remains predominantly customer-funded, with strong retail and SME deposit franchises. Customer behaviour and balances have remained relatively stable despite emerging cost of living challenges and rising rate environment. We have responded to base rate rises by increasing customer rates across our deposit range (on sale and closed products), ensuring all customers receive higher interest on their balances.

Wholesale funding comprises secured and unsecured debt issuances as well as participation in the BoE TFSME. The availability of TFSME, alongside strong customer deposit performance, has continued to reduce the Group's wholesale funding activity in 2022, with the only activity being an MREL transaction to support the Group's capital resources.

Mitigating actions:
Liquidity and funding risk is managed primarily with respect to the Group's liquidity risk appetite and liquidity coverage ratio. The Group prepares an annual Internal Liquidity Adequacy Assessment Process (ILAAP) to ensure that its liquidity risk framework remains appropriate and the Group holds sufficient liquidity resources.

The Group holds a portfolio of high-quality liquid assets (HQLA), alongside contingency funding actions which enable us to raise or preserve liquidity in adverse conditions, and assets available for BoE facilities.

Emerging risks:
Whilst the Group's liquidity and funding position is strong, we recognise that cost of living challenges, rising rate environment and market volatility relating to broader economic, domestic and geopolitical factors may impact the level of liquidity and funding risk in the future. The impact of wholesale market conditions on the Group's liquidity and funding position is limited as we have maintained surplus liquidity following use of TFSME in 2021. Given the strength of its liquidity, the Group plans to make initial TFSME repayments without reliance on wholesale market intervention, in turn minimising potential risks to NIMs and the Group's existing funding base. The Group recognises the potential for uncertainty in customer behaviour as the economic situation evolves, considering such risks in its management of liquidity resources.

Key indicators:
Loan to deposit ratio: 104.1% (2021: 99.1%). The Group's loan to deposit ratio has increased in 2022 as it has continued to support customer lending and manage its deposit base.
Primary liquidity resources: £5,586.9m (2021: £5,924.0m). While the Group has maintained an elevated level of liquidity through 2022, primary liquidity resources have reduced compared to 2021 where the year end position included TFSME drawings.
Liquidity Coverage Ratio: 265.3% (2021: 205.3%). LCR maintained significantly above regulatory minimum.

MARKET RISK

Definition:
Market risk is the risk of loss as a result of the value of assets or liabilities being adversely affected by movements in market prices, interest rates or exchange rates. .

Key themes:
The Group's business model and market risk framework mean that its main exposure to market risk is through potential mismatches in the profiles of customer assets and deposit liabilities. Underlying economic uncertainties and market volatilities have continued to present challenging conditions in which to manage the Group's market risk exposures. Market risks associated with fixed term mortgages are a continued area of focus, including managing pipeline risk and monitoring prepayment behaviour. We have established a new structural hedge in 2022, reflecting that a proportion of our demand savings balances are evidenced to be non-sensitive to interest rates. Alongside existing hedge structures for current accounts and other non-interest bearing balances, this provides additional natural hedge to mortgage origination, and a smoother income profile, while acknowledging the lag effect of the investment profile in the current rising rate environment.

Mitigating actions:
The Group has a clear market risk framework, with risk limits in place to monitor and manage exposures and impacts of market movements. The Group seeks to hedge market risks where appropriate, including matching of assets and liabilities where appropriate, as well as use of derivative

instruments (interest rate swaps) to manage remaining exposures. The framework has continued to provide a robust structure in 2022, adapted to changing conditions and continued to appropriately manage the Group's overall exposure to market risk.

Emerging risks:
The Group recognises the potential for further volatility in market conditions, in response to economic and domestic and geopolitical conditions. Specific risks to be managed include customer behaviours across lending products, (particularly with respect to customer repayment options on Bounce Back Loans), mortgage prepayment rates, as well as mortgage market conditions and pipeline risk as mortgage markets and performance respond to underlying economic conditions, higher base rate expectations and rate volatility.

The impact of severe events due to changing climate patterns or rapid shifts in climate change-related regulation around the world has the potential to cause sharp adjustments to market prices as well as interest rates and exchange rates. Increased market risk as well as operational risk could also arise as a result of disruption to business services, supply chains and transport links.

Key indicators:
PV01: measures the sensitivity of future cash flows to a one basis point shift in interest rates. More information is available in our Annual Report and Accounts, which is available on our website.

MODEL RISK

Definition:
Model risk is the potential for adverse consequences caused by models. Model risk can lead to financial loss, regulatory penalty or fine, poor business or strategic decision-making, incorrect financial reporting, damage to a bank's reputation or adverse customer outcomes.

Key themes and emerging risks:
The Group has permission to adopt the IRB approach for the majority of its exposures, which provides a significant capital benefit to the organisation relative to the Standardised Approach. A robust IRB attestation is completed annually to ensure permission is retained. The Group maintains an active dialogue with the PRA regarding adapting the secured models in line with regulatory expectations of PS11/20. Capital risk implications of major regulatory changes are covered in the capital risk section above. The model remediation programme, instigated in 2022, remains in place with submission of revised models to the PRA anticipated by end of March 2023.

Retail current account and credit card IRB models were implemented in 2022 with new developments for these models planned with PRA submission in 2024, in line with the IRB roadmap wave 4 Basel 3.1 implementation.

The COVID-19 pandemic presented unprecedented conditions that proved challenging to model accurately, particularly in the case of the Group's IFRS 9 models. The Group relied on the use of model adjustments to reflect these challenges. Defaults are expected to increase as the UK enters a prolonged recession and the cost of living crisis continues to manifest; as such the Group continues to rely on post model adjustments (PMAs) to mitigate these risks, reflecting concerns to specific sectors and to address model limitations in the high inflationary environment. Development of second generation IFRS 9 models remains an important priority.

Finally, as part of our close consideration of climate change risks as part of our ongoing strategic planning exercises (described in more detail in the Annual Report and Accounts, which is available on our website) the Group now maintains a modelled solution for assessing these risks across its largest portfolio in retail secured. This model is used to assess the impacts of climate change scenarios on credit losses, capturing both physical and transition climate risks and used for ongoing assessment in ICAAP cycles which informs future financial planning and risk monitoring.

Mitigating actions:
The Group operates a robust model governance framework, including independent model validation of all models, including new models, as well as ongoing monitoring of model performance and periodic risk appetite and policy refreshes.

The Group commits to providing Executive level review and challenge of model risk through its Model Risk Oversight Committee (MROC) which ensures that the model rating systems and material models are operating effectively and the impact of model risks on the Group's business model and strategies is assessed regularly. This also includes oversight of the Group's IRB permissions, including the exemptions where the Group applies the Standardised Approach to calculate Pillar 1 capital requirements.

The Group has in place a mechanism to determine PMAs to adjust impairment stock where it is determined that direct model outputs do not adequately reflect all risks within a portfolio, or subset of a portfolio. To mitigate the risk of capital requirements underestimation as a result of non-compliant IRB models, the Group applies PMAs where necessary.

Emerging risks:
In 2022 the PRA published CP16/22 which lays out the proposal that firms should implement an enhanced Model Risk Management Framework. Whilst the Group is well placed for compliance with the majority of the consultation paper, some refinement of the Group's Model Risk management will be required. Particular focus will be given to the change to the definition of models and hence greater emphasis on the Group's currently defined non-models.

Key indicators:
A range of indicators continue to be used to assess this principal risk. These include, but are not limited to, the number of models that are not IRB compliant, the volume of models rated with a ‘Red’ RAG status in terms of model performance or rated ‘Not Fit for Purpose’ following periodic model review.

PENSION RISK

Definition:
Pension risk is defined as the risk to Group capital and company funds from exposure to defined benefit scheme liabilities (to the extent that liabilities are not covered by scheme assets), associated funding commitments and risks inherent in the valuation of scheme liabilities. Uncertainty in the estimated size of the liabilities and volatility in future investment returns from the assets may cause volatility in the pension fund funding level.

Key themes and emerging risks:
The Group is the Principal Employer of the Bank section of The Co-operative Pension Scheme (Pace) and the Britannia Pension Scheme (BPS). Both schemes remain in surplus on an accounting basis and were also determined to be in surplus on the statutory funding basis at the time of their last completed triennial valuations, as at 2019 and 2020 respectively. We continue to assess the funding and accounting positions of both schemes, with a particular focus on any potential erosion of capital resources due to additional funding requirements.

Risks to the Group arise from the valuation of each scheme on each of the statutory funding and low risk target (a secondary funding measure for Pace) bases, a deterioration in which could give rise to additional cash contributions into the schemes in the future, and the accounting basis, which could give rise to immediate erosion of CET1 resources if the schemes were determined to be in deficit on the accounting basis.

Risks may arise if actual experience differs from the assumptions employed in valuations on each basis, in particular as a result of changes to market and economic conditions and longer lives of members. Risks may also arise due to volatility in the valuation of scheme investments. The Group remains cognisant of the potential future impact of climate-related physical or transition risks on pension asset valuations.

There is also a risk that the Group’s covenant weakens, potentially resulting in a perceived deterioration in scheme funding and a request from the trustees for additional cash contributions.

In September 2022, the Government announced its ‘Growth Plan 2022’, which was intended to tackle rising energy costs, bring down inflation and help businesses and households. Market reaction to the announcement led to a sudden and significant rise in interest rates and collateral calls on Liability Driven Investment (LDI) funds, which typically include derivatives. The significant levels of de-risking that the trustees have implemented, in consultation with the Bank, in recent years meant that both Pace and BPS had relatively low levels of leverage, segregated LDI mandates and liquidity available within their LDI funds and across their wider investment portfolios. This meant that the schemes demonstrated resilience and were able to withstand the pressures faced without reduction in the level of hedging or funding level of either scheme.

Mitigating actions:
In December 2022, the Pace Trustee completed a full “buy-in” transaction with Rothesay Life Plc, as specialist UK insurer, to insure scheme benefits through a bulk annuity insurance policy. Through this transaction, and in conjunction with a pre-existing partial “buy-in” with Pension Insurance Corporation plc (PIC) completed in April 2020, this means that the Bank Section of Pace, and by extension the Bank as Principal Employer, is fully insured against the primary investment and longevity risks it is exposed to.

The majority of the BPS’ inflation and interest rate risks are hedged through the scheme’s LDI strategy, minimising the overall volatility in the scheme. The BPS Trustee monitors leverage and collateral headroom in its segregated LDI portfolio, together with sources of liquidity in its wider portfolio, to ensure the scheme funding level can remain resilient in the face of rising interest rates.

The Group regularly monitors and stresses its pension scheme assets to understand potential for adverse impact of volatilities.

The scheme trustees are responsible for managing pension assets and do so in line with their Responsible Investment policies, taking advice from appointed investment consultants and investment managers. Whilst pension assets are exposed to general market conditions including interest rates, inflation and credit spreads, which could deteriorate under longer-term climate stress, the low-risk liability driven investment strategy, with high levels of interest rate and inflation protection (in BPS) and insurance assets (in Pace), are considered to go some way to mitigating the overall risk to the funding levels of the schemes posed by climate change.

Key indicators:
The schemes are both in a surplus position on an accounting and applicable funding bases. More information is available in our Annual Report and Accounts, which is available on our website.

REPUTATIONAL RISK

Definition:
Reputational risk is the risk of damage to the Group's reputation, or to the way The Co-operative Bank brand or image is perceived by its internal or external stakeholders as a result of its conduct, performance, the impact of operational failures, or other external issues.

Key themes:
It is critical to the success of our Plan that reputational risks are identified, managed and mitigated. We continued to maintain a strong 'customer first' culture in 2022 and responding to our customers' needs during the cost of living crisis.

Our Ethical Policy defines how we act as a business, the causes we support and the ways we use (and won't use) our customers' money. We continue to seek the views of our customers via the Ethical Policy which was updated this year, in conjunction with the Bank celebrating 150 years of ethical banking. This latest update to our Ethical Policy reflects the priorities of our changing world and is structured around our customers concerns for our planet, for people and for our communities.

This year also saw the launch of our new advertisement campaign "The Bank you can hold to account", which was positively received. With values and ethics at our core and a unique customer-led Ethical Policy, we are committed to using our customers' money to do good for the planet, people and communities.

Our unwavering commitment to co-operative values and ethics and our unique customer-led Ethical Policy have established us as a leading ambassador in environmental and social issues today. We have been recognised as the UK's best ESG rated high street bank by leading ESG analytics experts, Sustainalytics – our renewed ESG risk rating was 8.3, compared to 9.2 last year. In addition, we have also received an MSCI ESG rating of AAA (improved from an A rating), which reinforces our strong ESG position, and an improved ESG rating from rating agency ISS, who have now awarded us with their 'Prime' ESG label. This means that our tradeable bonds and shares now fall under their 'Responsible Investment' category. We will continue to champion the commitments to our Ethical Policy and drive our credentials within the developing ESG frameworks in 2023.

The Group continues to use the 'co-operative' name as we continue to concentrate on the strong and constructive relationship with Co-operative UK. The Group demonstrates its commitment to the co-operative values through our partnership with The Hive which began in 2016 and the programme has already helped over 1,000 new and existing co-operatives and groups. Through our partnership, we are helping to build a resilient and successful co-operative economy. We have invested £2m into this programme since our partnership began and this has led to positive feedback from Co-operatives UK. The Group can experience media coverage and social media content relating to matters such as speculation relating to the Group's ownership, call wait times in the contact centre and digital outages. The Group continues to focus on the successful delivery of the Plan and supporting our customers.

Mitigating actions:
An active dialogue has been maintained with all key stakeholders throughout the year. The Group continues to invest in channel offerings, including enhancing digital capabilities allowing customers to bank more flexibly and at their own convenience. Investing in technology to improve resilience has remained a focus, whilst utilising multiple communication channels to keep customers informed during outages.

Emerging risks:
Given the high level of scrutiny regarding financial institutions' treatment of customer and business conduct from regulatory bodies, the media and politicians, from time to time the Group may be exposed to conduct issues, legal proceedings and regulatory investigations that could give rise to reputational risk. Where appropriate, the Group discloses such exposures as contingent liabilities (further information can be found in the full Annual Report and Accounts, which has been made available on our website).

Key indicators:
A range of indicators continue to be used to assess changes in this principal risk. These include, but are not limited to, the number and nature of reputational risks, social media sentiment and adverse Ombudsman decisions made against the Group.

END

FORWARD LOOKING STATEMENTS

This document contains certain forward-looking statements with respect to the business, strategy and plans of The Co-operative Bank Holdings Limited and its subsidiaries (“the Group”), (including its updated long-term forecast) and its current targets, goals and expectations relating to its future financial condition and performance, developments and/or prospects. Forward-looking statements sometimes can be identified by the use of words such as ‘may’, ‘will’, ‘seek’, ‘continue’, ‘aim’, ‘anticipate’, ‘target’, ‘projected’, ‘expect’, ‘estimate’, ‘intend’, ‘plan’, ‘goal’, ‘believe’, ‘achieve’, ‘predict’, ‘should’ or in each case, by their negative or other variations or comparable terminology, or by discussion of strategy, plans, objectives, goals, future events or intentions.

Examples of such forward-looking statements include, without limitation, statements regarding the future financial position of the Group and its commitment to its plan and other statements that are not historical facts, including statements about the Group or its directors’ and/or management’s beliefs and expectations. Any such forward-looking statements are not a reliable indicator of future performance, as they may involve significant stated or implied assumptions and subjective judgements, which may or may not prove to be correct. There can be no assurance that any of the matters set out in forward-looking statements are attainable, will actually occur, will be realised, or are complete or accurate. Past performance is not necessarily indicative of future results. Differences between past performance and actual results may be material and adverse.

For these reasons, recipients should not place reliance on, and are cautioned about relying on, forward-looking statements as actual achievements, financial condition, results or performance measures could differ materially from those contained in the forward-looking statement. By their nature, forward-looking statements involve known and unknown risks, uncertainties and contingencies because they are based on current plans, estimates, targets, projections, views and assumptions and are subject to inherent risks, uncertainties and other factors both external and internal relating to the Group’s plan, strategy or operations, many of which are beyond the control of the Group, which may result in it not being able to achieve the current targets, predictions, expectations and other anticipated outcomes expressed or implied by these forward-looking statements. In addition, certain of these disclosures are dependent on choices relying on key model characteristics and assumptions and are subject to various limitations, including assumptions and estimates made by management. No representations or warranties, expressed or implied, are given by or on behalf of the Group as to the achievement or reasonableness of any projections, estimates, forecasts, targets, prospects or returns contained herein. Accordingly, undue reliance should not be placed on forward-looking statements.

Any forward-looking statements made in this document speak only as of the date of this document and it should not be assumed that these statements have been or will be revised or updated in the light of new information or future events and circumstances arising after today. The Group expressly disclaims any obligation or undertaking to provide or release publicly any updates or revisions to any forward-looking statements contained in this document as a result of new information or to reflect any change in the expectations with regard thereto or any change in events, conditions or circumstances on which any such statement is based, except as required under applicable law or regulation.